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ECONOMIC ANALYSIS AND THE EFFICIENCY OF GOVERNMENT

REPORT

OF THE

SUBCOMMITTEE ON ECONOMY IN GOVERNMENT

OF THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

TOGETHER WITH

SUPPLEMENTARY VIEWS

FEBRUARY 9, 1970

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LETTERS OF TRANSMITTAL

FEBRUARY 6, 1970.

To the Members of the Joint Economic Committee:

Transmitted herewith for your consideration and use and for the use of other Members of Congress, Federal Government agencies, the business and academic communities, and other interested parties, is a report entitled "Economic Analysis and the Efficiency of Government" by the Subcommittee on Economy in Government.

Sincerely,

WRIGHT PATMAN,
Chairman, Joint Economic Committee.

FEBRUARY 5, 1970.

Hon. WRIGHT PATMAN,
Chairman, Joint Economic Committee,
U.S. Congress,
Washington, D.C.

DEAR MR. CHAIRMAN: Transmitted herewith is a report by the Subcommittee on Economy in Government, entitled "Economic Analysis and the Efficiency of Government."

The report is based on hearings which the subcommittee held in May, September, and October of 1969. These hearings were a followup to the subcommittee publication of the three-volume study entitled "The Analysis and Evaluation of Public Expenditures: The PPB System," published in June 1969, and represented a continuation of the long-run efforts of the subcommittee to pinpoint areas of waste and inefficiency in Federal Government policy. Through the hearings, report, and three-volume study, the subcommittee has attempted to focus attention on the potential contributions of improved budgetary procedures and policy analysis in attaining efficiency in government.

I express the appreciation of the subcommittee to the experts who appeared before it as witnesses.

Sincerely,

WILLIAM PROXMIRE,
Chairman, Subcommittee on Economy in Government.

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ECONOMIC ANALYSIS AND THE EFFICIENCY OF GOVERNMENT

Introduction

This report is based upon the studies and hearings of the Subcommittee on Economy in Government of the Joint Economic Committee. These efforts of the subcommittee were designed to increase the effectiveness, responsiveness, and performance of Federal Government economic policy. The findings and recommendations of this report focus on civilian programs and policies and are based on two sets of hearings on and a three-volume study of public expenditure and budgetary policy.[1] The subcommittee recently issued a separate report on "The Military Budget and National Economic Priorities."[2]

Although these investigations covered Federal expenditure, revenue, and rulemaking policy, they concentrated on issues related to the planning of public spending programs and the choice among alternative program and policy strategies. Their objective was to spotlight serious weaknesses and inefficiencies in Federal expenditure policy and to demonstrate the role of economic analysis in correcting the resulting resource misallocation. In this report we shall concentrate on the budgetary process, the economic evaluation of public expenditure and rulemaking decisions, and on the economic considerations pertinent to effective policymaking in several specific expenditure areas.

NOTE.—Representative Patman states: "Because other responsibilities prevented my participating in the hearings on which this report is based, I do not wish to take a position on any of the conclusions and recommendations contained herein."

[1] U.S. Congress, Joint Economic Committee, "Guidelines for Estimating the Benefits of Public Expenditures," hearings of the Subcommittee on Economy in Government, May 12 and 14, 1969; "The Analysis and Evaluation of Public Expenditures: The PPB System," a compendium of papers prepared for the Subcommittee on Economy in Government, June 1969; and "Economic Analysis and the Efficiency of Government," hearings of the Subcommittee on Economy in Government, September and October 1969.

[2] U.S. Congress, Joint Economic Committee, "The Military Budget and National Economic Priorities," report of the Subcommittee on Economy in Government, December 1969.

I

Efficiency in Government Requires the Explicit Statement of Program Objectives, Careful Analysis of Alternative Means for Attaining Objectives, and Choice Based Upon Criteria of Economic Performance

It is a fair generalization that most Government programs and policies are designed to improve the allocation of society's resources or to alter the distribution of its income, or both. This is true for both expenditure and rulemaking policies. To satisfy these objectives, the Government seeks both to improve the efficiency of the market economy and to correct some shortcomings in private sector performance.

Consider, for example, the matter of efficiency in the allocation of resources. In many markets where competition is present, the market system efficiently allocates resources to produce those things most desired by consumers. However, in some sectors of the private economy, the independent decisions of buyers and sellers fail to generate an optimum allocation of society's resources. Some worthwhile goods and services are not produced at all while other goods and services are produced in either excessive or insufficient amounts.

In some cases worthwhile items are not produced by private businesses because markets for the sale of these products cannot be established. In other cases, everyone in the Nation is automatically benefited once the output is produced. Consequently, when these conditions exist, private businesses cannot recover their costs and consequently fail to produce the goods or services. Examples of goods which the private sector fails to produce include national defense, flood control, and the provision of a judicial system. The Government must assume responsibility for producing these *public goods* and *public services.*

In addition to the production of these public goods and services, Government subsidizes, taxes, restricts, or encourages the production of some other goods in order to attain an optimum allocation of society's resources. This public action is necessary because some kinds of production processes generate uncompensated costs or benefits which affect third parties. A primary example of a production process which creates *spillover costs* is the firm which uses public water courses or the air for waste disposal. While firms which discharge pollutants impose spillover costs on others, they do not bear these costs and the prices of their products do not reflect these costs. Consequently the firm's costs, prices, and the output level at which it produces is not optimum from society's point of view. To correct these undesirable effects, Government action is required.

The presence of monopoly in private sector markets is yet another economic efficiency rationale for public action. In some cases, monopoly power is due to natural factors such as technologies which require enterprises of large size relative to the market in order to achieve low costs and efficient operation. In other cases, the lack of competition is due to artificially contrived circumstances. Irrespective of the source of monopoly power, governmental regulatory, or legal action is required to correct the inefficiency, resource misallocation, high prices, and excessive profits which accompany its presence.

In addition to these, there are other shortcomings in the operation of the private economy which foster misallocation and necessitate public spending and rulemaking action. In certain markets, buyers and sellers lack the necessary market information to make economic choices. Similarly, resource immobility inhibits market adjustment in certain areas and markets. In all of these cases, governmental action is required to attain an efficient allocation of resources.

While some public programs are designed to improve resource allocation, other Government programs (for example, welfare programs) have been established in order to achieve desired adjustments in the distribution of income. Although equity objectives are often described in terms of some single aspect of human welfare (e.g., adequate diet, adequate housing, and adequate medical care), it is clear that a more equitable distribution of the Nation's income is the ultimate objective. Such a judgment on income distribution forms the basic rationale for social security, public assistance, veterans' benefits, and housing expenditures, as well as many of the programs designed to eliminate poverty.

Although such resource allocation or equity objectives form the rationale of most public programs, few programs contain an explicit statement of the precise objectives which the program is designed to accomplish. This lack of a specific statement of program objectives makes the application of sound planning procedures difficult to accomplish. It is becoming increasingly clear that a sound Government budgetary process requires far more explicit and quantitative statements of program objectives than now prevails.

The existence of the 26-million-unit housing goal is an example of the value of stipulating specific program objectives. In the case of the housing program, both the Members of Congress and planners in executive agencies have a concrete benchmark against which to gage their success and measure the efforts yet required. Moreover, the existence of this explicit statement and the concomitant measures of attainment enable decisionmakers to better evaluate the benefits and costs of alternative programs and strategies.

In establishing specific objectives, the efficiency and equity rationale of various kinds of governmental programs should be clearly recognized. The objectives of programs which are designed to correct resource misallocation generated by the private economy should be framed in terms of the economic benefits which are to be produced. The objectives of equity-based programs should be framed in terms of the income redistribution achievements which are desired. Where there are other than efficiency or equity objectives, these too should be spelled out and stated explicitly. It is only through such statements of objectives that the costs and gains of alternative policies can be compared and evaluated.

In addition to more concrete statements of program objectives, the Government decision process sorely needs increased evaluation of the economic costs and gains of alternative programs and policies. The information produced by such analysis can contribute substantially to governmental efficiency in programs designed to improve the allocation of society's resources as well as those primarily concerned with developing a more equitable society.

In citing the need for a more extensive and explicit application of economic analysis and evaluation to policy decisions, we urge that two basic criteria should be applied to public undertakings. For those public programs which are designed to improve the allocation of the Nation's labor and capital resources, the benefits and costs of alternative proposals can be expressed in quantitative and monetary terms. For such programs, the benefits are composed of additions to real national output while the costs entail reductions in the flow of the Nation's goods and services. Where benefit and cost measurement is possible, quantitative evaluation should be made and, with a constrained public budget, those alternatives with the greatest *net* benefits should be chosen. Government should strive to avoid those alternatives which divert resources from more productive uses in the private sector to less productive uses in the public sector.

Where the benefits cannot be expressed in quantitative or monetary terms, the benefit-cost comparison is not possible. Here economic analysis and evaluation must strive to measure the benefits in consistent physical terms and to determine the costs entailed by each of the options designed to accomplish an objective or set of objectives. That alternative which can accomplish the objective(s) at the least possible cost should be chosen.

A quite different criterion should be applied to programs designed to achieve equity objectives. For these programs to be effective, each dollar which is spent must aid the group(s) to which the program is directed by the greatest amount possible.

For example, assume that a program has the objective of raising the income of a particular "target group" of citizens, say, low-income farmers. Any expenditure in this program should be judged ineffective if a sizable proportion of the program expenditures benefits farmers with high annual incomes. Effectiveness in this context then refers to the extent to which an equity-based program provides benefits to the target group(s) of people relative to the benefits these individuals could receive under an alternative plan involving the same expenditure.

In the papers and statements presented to the subcommittee, many experts noted the difficulties of bringing considerations of public sector efficiency and the results of policy analysis to bear on bureaucratic and political decisions. Many witnesses observed the strong tendency for studies of efficiency and redistribution impacts to be kept "internal" and shielded from public view. In a period in which the responsiveness and performance of Government is open to severe question, we find this situation to be most regrettable. We urge greater congressional effort to develop arrangements for insuring a more comprehensive and, especially, more open application of economic analysis to public expenditure and rulemaking decisions.

Many experts also emphasized that Congress, especially, lacks access to information and studies of the economic and distributional effects of policy alternatives. We concur in this judgment. It is clear that much of the past transfer of policymaking initiative from Congress to the Executive is due to this lack of access to policy analysis and evaluative information. While many policy studies and economic evaluations encounter problems of measurement and definition, the open and explicit application of economic analysis to public decisions is an important step in achieving a government which is efficient and responsive to the demands of the people.

II

The Planning-Programing-Budgeting System Has Increased Concern for Efficiency in the Executive Branch but Has Had Little, if Any, Impact on Congressional Budget and Policy Decisions

The Planning-Programing-Budgeting (PPB) System was instituted in the Federal Government on a comprehensive basis in August 1965. Today, more than 25 agencies, including all of the primary Federal departments, are included in the system. The establishment of the system was based on what was perceived to be the contribution of the system's analysis effort to the decisionmaking process in the Department of Defense. The PPB System was expected to provide evidence on the costs and benefits of policy alternatives designed to accomplish an objective and to bring information on the performance and future costs of public programs to bear on the decisionmaking process. Ideally, it was to be the vehicle for generating open, explicit, and comprehensive economic evaluation of all programs and expenditures and establishing a decision process in which choices would be based on the results of analysis. The Bureau of the Budget was given responsibility for implementing this system in the executive branch and for assisting agencies in the development of methods of analysis and an analytic staff.

In the 5 years since the birth of the Planning-Programing-Budgeting System, many claims have been made concerning its effectiveness and the wisdom of its implementation. Many failures in the effort to apply economic analysis to public programs have been pointed out. On the other hand, successful efforts have also been recorded. In statements presented to the subcommittee, those responsible for administering the system argued that substantial progress has been made in applying comprehensive economic analysis to policy decisions. They claimed that executive decisions have been based on better information and a wider range of alternatives have been considered and evaluated. Parties to the political process have been forced to focus on the appropriate concepts of inputs and outputs, benefits and costs, and the pattern in which these are distributed among the people. In the evaluations of the PPB system received by the subcommittee, it was clearly recognized that, while economic analysis and information are of major assistance in developing effective public programs and policies, other factors are also important and must be considered in the decisionmaking process. In a paper presented to the subcommittee, the Assistant Director of the Bureau of the Budget for Program Evaluation stated:

> [The] quantity of adequate-to-excellent * * * analysis has increased by about 200 percent during the last 4 years. This may mean only that it has gone from five to 15 on the scale that has 100 as maximum, but it still represents considerable progress.

Through the planning-programing-budgeting process, the primary policy issues in each agency are identified annually by the Bureau of the Budget. Through a formal *Issue Letter* from the Director of the Bureau to the Agency head, an analysis of the issue is requested. Some of these analyses are to be done in a brief period of time and submitted to the Budget Bureau in the form of *Program Memoranda.* Other analyses are expected to be more substantial, entailing research taking several months. These studies, when completed, are presented by the agency to the Bureau in the form of *Special Analytic Studies.* The results of program memoranda and special analytic studies are intended to influence both the formation of policy within the agency itself as well as to be instruments of budgetary control for the Bureau of the Budget. In addition to these components, the PPB system has produced a document entitled *Program and Financial Plans.* In this document, agencies prepare 5-year projections of program budgets which record the budgetary implications of commitments already made. Moreover, where feasible, the program and financial plans project program outputs for the same 5-year period. In appendix 1, the Budget Bureau's formal appraisal of the success of each of these components of the PPB system is presented.

While it appears that the PPB System has led to some gains in the executive budgetary process, we judge that substantial progress toward a rational, consistent, and economic budgetary process in the executive branch has yet to be made.

It is not surprising that progress in reforming the Federal Government budgetary process is so difficult to achieve. The procedures of budget making and allocation are locked in the cement of tradition. In statements presented to the subcommittee, witnesses documented a number of specific obstacles which impede the efforts to make the results of analysis effective in decisionmaking. These obstacles include—

- The failure of many agency heads to demand program analysis or to use it in decisionmaking when it was available;
- The lack of interest in the PPB System by some congressional committees and Congressmen;
- The failure of much legislation to clearly stipulate program goals and objectives and to provide funds for the collection of followup data and other program appraisal information;
- The existence of private interest groups which anticipate that hard and quantitative program evaluation will endanger the size or existence of expenditures which benefit them;
- The constraints on substantive and time-consuming policy analysis imposed by the annual budget cycle and process to which the PPB System is tied;
- A serious scarcity of analytical personnel in the PPB office of civilian agencies;
- A basic resistance by many Federal employees to economic analysis and the difficult job of program evaluation;
- The lack of professional agreement on certain basic analytical issues, such as the appropriate public interest rate for discounting long-lived public investments, the development of shadow prices when outputs are not marketed, the evaluation of expenditures with multiple objectives, and the evaluation of public expenditures in regions or periods of less than full employment; and

- The lack of adequate data from which to develop measures of the social benefits of outputs and social costs of inputs.

More serious than the failure of the PPB System to achieve radical improvements in the executive budgetary process has been the failure to design the system to respond to the needs of the Congress. Indeed, at the time of its establishment, the PPB System was viewed solely as an executive branch reform. The original document guiding its implementation gives no indication that the system could or should be of assistance to the Congress. There are, it appears, two other reasons which account for the failure of the system to respond to the needs of Congress. Several witnesses emphasized the difficulty of generating sound analysis and evaluation of alternatives within the agencies if it is known that either the analytical documents or the results of the analyses will be made public. They argued that any general policy which would result in the automatic publication of program studies would either drive such analysis underground or destroy it. Moreover, it appears that the failure of the system to assist Congress in part reflects the basic presumption of some that the executive branch can control and govern itself without interference from the legislative branch. On the basis of some combination of these reasons, the Bureau of the Budget has refused to reveal to the Congress the studies and information produced by the PPB System. Many of these studies, it must be emphasized, would be of substantial assistance in improving the efficiency and effectiveness of congressional program and appropriation decisions. Without information of this kind, the ability of Congress to even ask the right questions concerning program performance is seriously impaired.

Program Memoranda, containing quantitative evaluation of the benefits and the costs of individual programs as well as other evaluative information, have been retained by the Bureau on grounds of executive privilege. Special Analytic Studies, presenting the results of detailed study of the efficiency and equity consequences of alternative means of obtaining objectives, are from time to time released, but only after the executive has made a policy decision and then only in a form designed not to upset the decision. Program and Financial Plans, with program budget projections, are held within the executive on grounds of lack of data and the unreliability of estimates. While the list of issues on which the Bureau of the Budget is requesting analysis in the planning and budgeting cycle has been released to the Congress through the subcommittee, the results of the analyses of these issues have been withheld. If these policy matters are indeed "issues" awaiting decision, it is essential that Congress secure pertinent economic evaluation and analysis of the sort contained in these studies.

While we recognize that some of the results of the PPB System should be retained in the executive, the use of executive privilege has been too extensive. The lack of congressional access to much of this information and analysis seriously hinders legislative efforts to scrutinize and control the budget. The widespread use of executive privilege to retain the results of program evaluation and analysis is inimical to the development of an open and responsive political system in which public policy is made by elected political leaders rather than by an anonymous and powerful bureaucracy.

The subcommittee is encouraged by the clear recognition of this problem by the present administration and its willingness to seek a solution to the apparent impasse. The stated willingness of Director of the Bureau of the Budget Robert Mayo to initiate administration discussions on this matter is particularly welcome. These discussions should seriously consider the establishment of a legislative-executive commission with responsibility for designing a procedure for legislative use of analysis produced by the executive and resolving the issue of executive privilege.[3]

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[3] This suggestion was presented to the subcommittee by former Director of the Bureau of the Budget Charles J. Zwick. He stated:

"Perhaps the time has come to create a commission on the appropriate role and limits of analysis in the development of public policy. A commission could be created by congressional action or by presidential initiative. If the commission is to be successful, it must include representatives of both the legislative and executive branches of government. Nongovernmental members should include both technicians and other individuals with experience in government.

"Hopefully, such a commission would define a framework for the support and the use of analyses focused on public policy decisions. High on my list of concerns for the commission would be the issue of privileged information. This highly important matter should not be left to the partisans whether they are in the executive branch, congress, or technicians.

"Research workers, for example, have a bias for complete disclosure. This problem alone will tax the best judgment of the commission members and is key to furthering the role of analysis in public policy formulation.

"I am normally suspicious of commissions, but I believe the time is now appropriate for this one."

Recommendation

1. Arrangements should be developed to provide the Congress with increased access to executive branch studies, analyses, and evaluations pertinent to appropriation and program decisions. The Government Operations Committees and the Bureau of the Budget should assume responsibility for resolving this matter. Serious consideration should be given to the formation of a high-level executive-legislative commission to evaluate alternative arrangements.

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III

The Congress Requires a Capability To Provide Objective Policy Analysis and Program Evaluation Studies on a Continuing Basis

The relationship of the executive and legislative branches pertaining to the use of executive analysis and evaluation documents is a serious problem. More serious, however, is the failure of the Congress to provide itself with an analytical capability. Currently, the Congress has neither an adequate capability to interpret or evaluate studies done by the executive and those outside of Government nor the necessary capacity to undertake policy analysis of its own. As one administration witness before the subcommittee stated—

> You [the Congress] have some outstanding people who can provide program evaluation, but very few. I frankly think that Congress is not very well equipped to provide that evaluation.

The witnesses who appeared before the subcommittee and who addressed themselves to this matter concurred in this general appraisal of congressional capability.

If Congress is to increase the effectiveness with which it reviews and scrutinizes program and appropriations decisions, it must move with dispatch to establish an Office of Economic Evaluation and Analysis to provide all Members of Congress with objective and independent program studies and policy analyses. This Office should be staffed with competent economic analysts and should assist all congressional offices and committee staffs in gaining access to information on the costs, benefits, and distributive impacts of program and policy alternatives. The Office of Economic Evaluation and Analysis should have responsibility for (*a*) stimulating and drawing from policy analysis work done in the entire analytical community; (*b*) staying abreast of analysis information and results as these develop in the executive branch; (*c*) establishing congressional liaison with university analysts and those in research institutions; (*d*) monitoring in the sense of testing assumptions and checking data of studies forthcoming from any source; (*e*) translating into a form appropriate for open congressional debate the results of complex and technical analytic studies; and (*f*) providing evaluation information and analysis to Members of Congress, congressional committees and their staffs.

To assure ready access by all congressional offices, this Office of Economic Evaluation and Analysis should be an integral part of the Congress. The analytical studies prepared by this Office would assist all Members of Congress, congressional committees, and their staffs in much the same way that the studies prepared by the Joint Committee on Internal Revenue have aided the Ways and Means and Finance Committees and their staffs. Indeed, the work of the Joint Committee on Internal Revenue and the analytical and informational role which it plays could serve as a model or guide for the efforts of this Office.

Because its primary purpose would be that of interpreting, evaluating, and translating the results of studies done in the executive and outside of Government for use on congressional policy deliberations, it would complement the development of an analytic and in-depth evaluation capability now underway in the General Accounting Office.

An appropriate location for this staff unit is the Joint Economic Committee. Indeed, the mandate given this committee by the Employment Act of 1946 is sufficiently broad to enable the establishment of this Office with no additional legislation. If established as an adjunct to the Joint Economic Committee, the Office should have a professional, nonpartisan, staff, which is insulated from the current responsibilities and functions of the committee.

Recommendations

2. An Office of Economic Evaluation and Analysis should be established as a autonomous nonpartisan staff unit within the Joint Economic Committee. This Office would be responsive to all congressional offices and would assist them in obtaining analytical studies, data, and information on policy and program alternatives.

3. Additional funds for procuring specific analyses of Federal programs and policy areas should be appropriated and allocated to the committees with substantive program responsibilities. These studies would provide Congress with independent appraisals of programs and decisions and would reduce congressional reliance on the executive branch for such information.

IV

The Federal Budget Document Has Serious Deficiencies as an Instrument of Economic Policy and the Rational Allocation of Public Expenditures

The 5-volume Federal Budget document is the basic economic document of the Federal Government. It is virtually the only source of information concerning the cost implications of Government choices among alternative expenditure programs.

On several occasions over the past decade, the Joint Economic Committee has studied the structure and composition of the budget document. Numerous recommendations designed to improve the quality, accessibility, and usefulness of the budget as an economic document have been made.[4] In the past few years, a number of these recommendations have been implemented, resulting in an improved budget document.

The publication of the budget in several forms, with different levels of detail, has improved its usefulness to the Congress and has increased its accessibility to a wider range of interested citizens. The development of the unified budget concept, based on the report of the President's Commission on Budget Concepts, has reduced the previous confusion among the "cash," "administrative," and "national income accounts" budgets and has encouraged use of the budget as an economic as opposed to an accounting document. Further, the increased use of appendices for "special analyses" pertinent to budgetary control represents a significant improvement.

These developments notwithstanding, there are still major shortcomings in the budgetary document. Most of the committee's recommendations have not been followed. The Bureau of the Budget appears reluctant to open up to public scrutiny any budgetary information save that directly related to either the annual budget proposal or past years' expenditures allocated to agencies and functions in "line-item" fashion. The scope of the budget document is still far too limited to enable rational consideration of economic policy alternatives by the Congress.

The primary purpose of the budgetary document is to assist Congress in allocating expenditures among alternative programs and in making decisions on other economic policy matters, such as the tax reform effort recently undertaken by the Congress. The basic characteristic of all of these decisions is that they have economic consequences. They benefit some people while imposing costs on others; they stimulate some regions of the Nation often at the expense of economic growth in others. While some of these decisions are efficient, others entail costs in excess of benefits. While some of them make

[4] See especially, U.S. Congress, Joint Economic Committee, "Federal Expenditure Policies for Economic Growth and Stability," report of the Subcommittee on Fiscal Policy, 1958; "The Federal Budget as an Economic Document," staff study prepared for the Subcommittee on Economic Statistics, 1962; "The Federal Budget as an Economic Document," report of the Subcommittee on Economic Statistics, 1963.

the distribution of income more equitable, others do quite the opposite. If the Congress is to choose wisely among the many policy and budgetary options, it requires more comprehensive information on the economic consequences of decisions than is now available. While the current budget document itemizes direct Federal expenditures by agency and by functional categories, there is a great deal of necessary economic information which is either excluded from the budget document or hopelessly buried in a welter of detail.

A Program Budget

Each of the major objectives of the Federal Government is served by several programs administered by a number of executive departments. Nowhere in the budget document have the major program objectives of the Federal Government been stipulated along with the direct expenditures contributing to the attainment of these objectives, irrespective of the administering agency. Sound and rational decisions cannot be made if major elements of cost are charged to budgets which give no indication of the objective being served.[5]

While we recognize the difficulties of establishing meaningful, comprehensive, and consistent program structures, the potential improvements in economic expenditure policy from such a full program budget warrant the expenditure of substantial effort toward developing such a structure. It should be emphasized that budgeting on a program basis does not require elimination of the agency line item budgets or the functional budgets. All of these budgetary formats can be linked by an appropriate "crosswalk."

Comprehensive Budget Projections

Budgetary information in the current budget document is backward looking. The budget requests of the Executive are presented to the Congress with only the past level of appropriations and expenditures as background. The effect of this form of presentation is to induce excessive emphasis on the question: "Is the budget for agency (item, function) *x* being increased or decreased from last year?"

Because of the absence of prospective data the Congress possesses no indication of the future expenditure consequences of policy decisions which it has already made. There is, for example, no reflection in the budget document of the enormous future expenditure commitments made by a congressional decision to appropriate the first 1 or 2 percent of the cost of new procurement and construction projects. Surely a responsible decisionmaking process requires that, at a minimum, the future budgetary implications of the decisions already taken be displayed in the basic budget document.

The subcommittee takes special note of existing legislation which requires the executive branch to present to the Congress 5-year budget projections on new programs and additional or expanded program

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[5] The allocation of Defense Department requirements for atomic warheads to the budget of the Atomic Energy Commission was cited in the subcommittee hearings as an example of the difficulties of sound budget policy without program budget information. Similarly, the fact that the bulk of Federal support for police training is hidden in the budget of the Veterans' Administration hinders the development of sound and rational Federal law enforcement policy.

functions involving more than a $1 million annual expenditure. Public Law 84–801, which requires such annual projections, is shown as appendix 2 to this report. While the executive has responded to the few congressional requests for such projections, it has not generally met the requirements of this law. The subcommittee reminds the administration of its responsibilities in this regard. We, in addition, urge that such 5-year projections be prepared for all programs and submitted to the Congress.

Program Overview Information

Each member of the Congress should be able to clearly discern the characteristics of the programs on which he is being asked to spend taxpayers' money. He must be able to readily determine the objectives of the program, the character of program outputs, the value of these outputs, the method by which program benefits are distributed to the people, and the characteristics of the people who are benefited or hurt by the program.

An important start toward providing this overview type information has been made by the Bureau of the Budget in its program overview study. Through this study, benefit-cost ratios are estimated for each Federal program, as well as a breakdown of the program benefits by income class, geographic region, race, and so on. In appendix 3 to this report, a sample format of a program overview sheet is presented, along with data on five individual programs.

We commend the Bureau for initiating the preparation of this data. It is long overdue. The calculations necessary to complete these tables should be made as soon as possible and for all Federal programs, and a complete display should be presented in the budget document.

A Regional Budget

The current budget document provides no information on the regional impacts of Federal spending. Without such, the Congress is seriously hindered in developing consistent national policy for regional objectives.

Moreover, because program expenditures are not broken down regionally, the priorities of localities and regions cannot influence the mix of Federal appropriations. Insofar as many Federal budgets—including those for hospital construction, pollution control, and highways, for example—are decided nationally the choice offered the locality or region is a take-the-gift-or-leave-it choice. The region is given no chance to say: "Highway project X is of relatively low priority to us, while hospital project Y is far more important." Consequently, the ability of the Federal Government to respond to the needs of localities and regions, *as the people there see these needs*, is decreased. Substantial gains would result from the formation of a regional breakdown for major portions of the budget.[6]

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[6] In a statement presented to the subcommittee, former Director of the Bureau of the Budget Charles L. Schultze described the desirability of regional budgets combined with some grant of allocation authority to local and regional officials as follows:

"Experimentation with a limited form of regional budgeting could be very worthwhile. Tentative functional budgets could be drawn up on a national basis, just as they are now. But in each locality, Governors and mayors could be given the right, up to some limit, to

"Tax Expenditure" Analysis

Currently, special provisions in the Federal tax structure—referred to as tax expenditures—provide $45 billion in subsidies to specific groups or activities. It is increasingly recognized that these special provisions in the tax structure entail a loss of Federal revenue and, hence, represent an expenditure of tax dollars in the same way as Federal spending. Consequently, dollars of tax expenditures have resource allocation effects similar in nature to and fully as significant as those stemming from dollars of direct spending. For example, tax expenditures in the form of the oil depletion allowance cause reallocations of labor and capital from one firm to another, from one region to another, from the production of one kind of output to another, in the same way that a Federal spending program say, the highway program, reallocates resources. Similarly, it is increasingly recognized that substantial redistributions of income can be accomplished by either mechanism.[7]

While the current budget document does classify direct expenditures by agency and function, it does not even mention tax expenditures. Needless to say, the budget provides no information on the resource allocation and income redistributive impacts of these special tax provisions.

Because of the failure of the Executive to present the detail of these tax expenditures to the Congress on a regular basis, either through the budget document or some other vehicle, congressional efforts to develop coordinated and efficient public policy are severely impeded. The difficulty of forming appropriate expenditure decisions with little direct knowledge of the costs and gains of alternatives is complicated severalfold by the nearly complete lack of knowledge on the existence, size, and economic impacts of tax expenditures. Indeed, without this information, the Congress cannot know if the economic effect of the direct spending which it is undertaking duplicates, offsets, or complements the economic effects of tax expenditures.

In the subcommittee hearings, Stanley S. Surrey, former Assistant Secretary of the Treasury, described the need for knowledge of the economic and equity effects of tax expenditures in the following terms:

> The total of these tax expenditures is over $45 billion. Now, $45 billion of expenditures is a large amount to be lost or misplaced. * * * Yet, these $45 billion are in a real sense lost in our Government accounts. * * * One suspects there is much waste and water in the tax expenditure budget. [They] are * * * to be classified among the uncontrollable expenditures of government. * * * When [, for example,] the government spends nearly $1 billion on buildings through * * * [tax expenditures], what is it obtaining? * * * Clearly, we are in need of applying the techniques of cost-benefit analysis and program planning to

propose reallocations among particular Federal aid funds flowing into their jurisdictions. They might propose, for example, an increase in funds for education and a decrease in highway grants. In effect, the final allocation of Federal budgetary funds would arise out of a joint set of considerations—national allocations based on nationwide objectives, modified by reallocations based on conditions and preferences in particular communities. Functional budgeting would be supplemented where appropriate and feasible by regional budgeting."

[7] In the hearings of the subcommittee, Budget Bureau Director Mayo quoted President Nixon as follows:

"Tax dollars the Government deliberately waives should be viewed as a form of expenditure, and weighed against the priority of other expenditures. When the preference device provides more social benefit than Government collection and spending, that 'incentive' should be expanded; when the preference is inefficient or subject to abuse, it should be ended."

these tax expenditures, many of which have not been studied at all.

He noted that in some functional categories of the budget, tax expenditures exceed the volume of direct budget outlays—"for example, in community development and housing, the tax expenditures are nearly 200 percent of the budget outlays."

Arguments made with respect to tax expenditures apply with equal force to Federal programs which involve lending or loan guarantees and public enterprises. All of these activities involve resource allocation effects of a magnitude several times that implied by the direct appropriation or expenditure recorded in the Federal budget.

For example, a Federal program which pays a portion of the interest cost on private loans for some purpose is likely to be a relatively inexpensive program in budgetary terms. However, it is likely to induce increased borrowing and economic costs by several times the budgetary outlay of the Government. To the exent that this borrowing would not have taken place in the absence of the Government program, resources are being reallocated from their alternative uses. Much this same sort of "resource swinging" leverage is present in Federal Government loan guarantee programs. Again, rational and consistent policymaking requires that the Bureau of the Budget substantially increase the amount of economic information on the resource allocation effects of these forms of public expenditure policy in the budget document.

Subsidy Program Information

About $10 billion of annual direct Federal expenditures provide subsidy to special groups or individuals. The fact that these expenditures are labelled subsidies does not argue that they are either inefficient, inequitable, or inappropriate instruments of public policy. While some of these subsidy programs are designed to give incentive to individuals and businesses to pursue social objectives, others represent outright gifts or grants with no implied private response. While some of these programs grant subsidy by directly transferring income to the selected individuals, other subsidy programs aid the beneficiary groups by giving them valuable goods and services either free of charge or at a price which is below cost. As we noted in the previous section, still other Government subsidies are awarded through special allowances in the tax system—"tax expenditures"—or loans provided at preferential terms.

As the 1965 study of subsidy programs published by the Joint Economic Committee noted, many of the largest and most prominent Federal programs are providing subsidies to selected individuals.[8] These include—

- Agricultural subsidies;
- Airport construction and navigation aids;
- Direct loan programs of several varieties;
- Insurance programs of several types;
- Navigation and irrigation facilities construction;
- Pollution control grants;
- Shipbuilding and ship operating subsidies; and
- Welfare programs.

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[8] U.S. Congress, Joint Economic Committee. "Subsidy and Subsidy-Effect Programs of the U.S. Government," study prepared by the Legislative Reference Service of the Library of Congress, Mar. 31, 1965.

Often as a side effect of their primary purpose, these programs provide implicit subsidy to particular groups at the expense of taxpayers in general. For this reason, they should come under particularly close scrutiny by the Congress and the administration. As circumstances change, the relative priority given many of these programs may be reduced and the program cut back or eliminated. Indeed, it should be presumed that the necessity for all of these subsidy programs should be eliminated with the passage of time. Whatever their initial justification, these programs should be structured so as to eliminate the need for their existence in as short a time as possible. If we fail to adapt the scope and character of each of these subsidy programs in response to changing economic circumstances, higher priority objectives will be neglected and taxpayers will bear an unnecessary burden.

Although considerations of efficiency in Government demand that particularly careful and regular scrutiny be given these subsidy programs, the budget document provides no assistance whatsoever. There is no special analysis of these subsidy programs and their budgetary costs, nor is there any analysis of their future budgetary requirements, the characteristics of the people being subsidized, and the amount of subsidy which they are receiving. In fact, there are no regular reports from the Budget Bureau or any other executive agency on the economic and equity impacts of subsidy and subsidylike programs. The executive branch and especially the Bureau of the Budget should, in the course of the budgetary process, recognize their responsibility to provide the Congress with the data and analysis necessary for informed decisions on these public subsidy programs. Improved public policy in these areas requires the clearest possible exposition of their purpose and economic effects.

Recommendations

4. The Bureau of the Budget, in consultation with appropriate congressional committees, should immediately undertake a major effort to expand the comprehensiveness of the budgetary document. This effort should be directed at providing, in an open and explicit form, information on economic and equity impacts of all Federal programs. This revised budget document should include, where feasible—

(*a*) A breakdown of the Federal budget by detailed, Government-wide program categories;

(*b*) Five-year budget projections for each major Federal expenditure program, describing the future implications of commitments or decisions made and proposed, of the sort required by Public Law 84–801 for new programs;

(*c*) An experimental regional budget covering those Federal programs of a grant, construction, investment, or project-type nature;

(*d*) A detailed analysis of "tax expenditures" including a functional and agency breakdown of these "expenditures"; and

(*e*) A detailed analysis of the full economic and distributive impact of subsidy and subsidylike programs, including those involving loans and guarantees.

5. The Bureau of the Budget should accelerate its efforts to develop a full *Program Overview* study with a view to releasing it to the Congress. When developed, this study should be updated annually and submitted to the Congress as a separate report. This study should have the general format shown in appendix 3 and include estimates of benefits, costs, and income redistributive impacts of all Federal Government programs. All new legislative proposals forthcoming from the Executive should be accompanied by the information and data shown in the format in appendix 3.

6. The Joint Economic Committee should, as part of its annual hearings, explicitly consider those sections in a revised budget document displaying 5-year budget projections of Federal programs, analyses of "tax expenditures" and Federal subsidy programs and, when prepared, the Budget Bureau's *Program Overview* study.

V

The Procedures for Estimating the Benefits of Public Programs Are Inconsistent Across Government Agencies

Benefit-cost analysis is a powerful tool in analyzing and evaluating the economic worth of public policies, both prior to decisions to undertake new projects and programs and as a basis for revising, enlarging, or abandoning existing programs. However, for economic analysis to be helpful in isolating those policy alternatives which contribute to the Nation's economic welfare, it is essential that consistent and uniform definitions of economic benefits and costs be developed and applied.

Because the primary basis for many Government programs is to correct for some inadequacy in the economic performance of private sector markets, the basic definition of benefits should be an economic efficiency definition. Estimates of the benefits of Government programs should accurately measure the contribution of the program to national economic welfare. It should be emphasized that estimating the benefits of Government programs is possible and should be pressed even when some economic-type contributions cannot be expressed in dollar or income terms.

In citing contributions to economic welfare as the basic criterion, we in no way mean to deny the multi-objective character of many public programs. Government programs contribute to income redistribution and environmental quality goals in addition to increasing national income. Planning and evaluation reports should present comprehensive information on the effect of a program or project on these goals as well as on national economic welfare, even though many of these noneconomic objectives cannot be quantified in dollar or market-valued terms.

Although many public programs have several objectives, it is important that their contribution to national economic efficiency be separated out and calculated explicitly. The basic efficiency question is: "Does the economic value of the outputs produced by the public undertaking (benefits) exceed the value of the resources drawn from the private sector to support the public project (costs)?" If the answer to this question is affirmative, it is reasonable to presume that the undertaking improves the allocation of the Nation's resources. Similarly, if the answer to this question is negative, it is to be presumed that the program does not improve resource allocation. To attain Government efficiency, such programs should not be undertaken unless substantial and positive side effects on the noneconomic objectives can be clearly demonstrated.[9]

A second basic problem in evaluating public undertakings is associated with what are referred to as secondary benefits. These are typically defined as the favorable impacts on a locality or region due to the placement of a Federal installation in the region. For example, the restaurants in a region often grow and increase in profitability when the Federal Government establishes a national park or recreation facility in the vicinity. Many suggest that these increases in revenues or profits should be added to the national benefits of an undertaking in making the evaluation for Federal funding.*

On the basis of testimony by economists and other experts before the subcommittee, we feel that secondary effects do not signify net gains to the Nation as a whole in the same way as the direct outputs of an undertaking. The basic reason for this conclusion is that secondary effects are a part of every transaction made in the economy, both on the cost side and benefit side. Consequently, when the Government taxes to obtain the funds to pay for a project, citizens and businesses throughout the economy cut back on their spending and production. This cutback, in turn, generates secondary costs by reducing the sales of many businesses throughout the economy. These secondary costs must be set against any possible secondary benefits which might be generated. When the economy is functioning smoothly, there is no reason to expect that secondary costs will exceed secondary benefits or *vice versa*.

It should be emphasized, however, that when the economy is not functioning smoothly or when there are imperfections, such as labor immobility or regional unemployment, appropriately placed Federal expenditures which make use of unemployed labor or capital will generate secondary-type benefits which represent gains in national economic welfare. In such circumstances, the size of the secondary impacts should be measured and included in the economic evaluation of the national benefits of the project or program.[10]

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*Senator Symington states:

"I believe that experience shows that secondary benefits resulting from government investment in resource development often does result in net gain not only to the immediate locality but to the region and the Nation."

[9] These comments reflect our general agreement with the positions taken by the Bureau of the Budget and professional economists in hearings before the subcommittee. Dr. Jack Carlson, Assistant Director of the Bureau of the Budget for Program Evaluation stated:

"The proper concept of national income benefits is the goods and services that are provided by the projects versus conditions without the projects. These benefits can be related to the costs that are entailed by building the projects versus not building them.

"We need to encourage improved measurement of the national income benefits and costs and keep them separate from measurement of other objectives. Second, we need to display separately, and on a more regular basis, benefit measurements of the other objectives, along with the national income objectives."

Similarly, Dr. Jack Knetsch, professor of economics and director of the Center for Natural Resource Policy Studies at George Washington University, emphasized that:

"* * * [T]he outputs of public investments should be evaluated by the actual or simulated market demands of the users in terms of their willingness to pay, that is, to forgo other products, and that the costs must measure the value of the opportunities forgone by diverting inputs to the public investment from other uses. Were public sector investments to be chosen on other grounds, they would be employing resources which could be producing a greater value in other uses. Such public undertakings, by diverting resources from a higher to a lower valued use, would cause a decrease in society's economic well-being."

[10] These conclusions represent the views of all of the economic experts appearing as witnesses before the subcommittee. The following statement by Dr. Jack Knetsch is typical of their analysis:

"If the conditions for a smoothly functioning market economy prevail, there is no justification from a national point of view for the recording of secondary benefits which would accrue to the region of project location, nor for the recording of secondary costs which are experienced elsewhere in the economy due to the financing of the public project.

"This logic also generates the conclusion that where serious market imperfections are present, there may be secondary effects which do entail changes in the Nation's net income and which will require either the measurement of secondary benefits and costs or adjustments to the observed values of the primary benefits and costs."

In the subcommittee hearings, several additional matters pertaining to benefit estimation were emphasized by the witnesses. Here we simply list the major points which were made, together with a sample of the pertinent testimony, and state our general agreement with them:

1. Congress should earmark funds for evaluation by the executive branch of the economic effects of the programs which it funds and insist on release of evaluation studies.[11]
2. The evaluation of public programs should give increased attention to the disbenefits (or costs) which many of these undertakings produce.[12]
3. Planning of public programs should explicitly consider all of the objectives which any program is designed to serve. However, in program evaluation, the costs of attaining noneconomic objectives should be kept separate from the calculation and comparison of economic gains and costs.[13]

The subcommittee is encouraged by the efforts already undertaken by the Bureau of the Budget to insure appropriate and consistent procedures for evaluating public expenditures. The issuance of guideline circular A-94 this past year will go far toward insuring consistent discounting practices in evaluating long-lived investments. This circular should be used as a model in developing additional guideline documents to establish consistent definitions and measurement practices.

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[11] Mr. Elmer Staats, Comptroller General of the United States, stated:

"Public Law 90–174, cited as the 'Partnership for Health Amendments of 1967' provides that a portion of the appropriations for certain programs and grants be made available for program evaluation. If made available to congressional committees, these evaluations would be more meaningful in the legislative process, especially if the Congress specified some of the alternatives to be analyzed or issues to be dealt with."

[12] Mr. Elmer Staats argued that:

"In approving a program based on its expected positive results, more consideration should be given to measuring social disbenefits that may also result. These losses of social benefits have been called external diseconomies by economists. For example, Herbert Mohring in discussing benefit-cost ratios of urban highway investments says in part 'poorly planned freeways can do, and likely have done, serious damage by fragmenting communities, disrupting existing communications patterns, and the like.'"

This point was emphasized by Dr. Anthony Downs, Vice President of the Real Estate Research Corporation, who estimated that the noncompensated social costs imposed by Federal highway and urban renewal projects are about $200 million per year.

[13] With respect to the treatment of the costs of attaining nonmeasurable objectives, Dr. Jack Carlson stated:

"I feel it is misleading to arbitrarily allocate project or program costs to each measure of different objectives. We frankly do not know how to allocate project costs when a project provides multiple outputs. Until we know we should not dilute the one measure that can appropriately compare national income costs and benefits." (This position was also taken by the other economic experts appearing before the subcommittee.)

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Recommendations

7. The Bureau of the Budget should prepare a guideline document on benefit estimation to establish consistent and economic estimation practices in all Federal departments. This document should delineate those programs for which benefit estimation is to be required, state the appropriate concept of economic benefits, set forth a uniform procedure for dealing with secondary impacts, and present a general accounting framework to deal with effects on social objectives such as income distribution and environmental quality.

8. The executive branch should be required to stipulate explicit and, to the extent possible, quantitative program objectives in all new program proposals.

9. Earmarked funds for program evaluation and benefit estimation should be consistently provided in authorization and appropriation legislation pertinent to programs whose continued funding rests on program performance.

VI

Numerous Government Programs Misallocate Economic Resources and Benefit High Income Groups at the Expense of the Poor

In the recently completed hearings before the Subcommittee on Economy in Government, a number of economic case studies evaluating specific programs or program areas were presented. These case studies critiqued the program area in question, analyzed the economic benefits and costs generated by the program, and described the characteristics of those who benefited and those who bore the cost of these programs. These studies were all prepared by economic experts who have devoted substantial study to the evaluation of the programs which they critiqued.

The results of these studies are most disturbing. In the overwhelming majority of cases, economic experts described major inefficiencies, inequities, and performance shortfalls in public programs. Several programs were characterized as either misallocating national resources (in that the costs of the program exceeded the benefits) or ineffective in accomplishing the objectives for which they were designed. Economic experts argued that a number of Federal programs entailed serious and undesirable distribution consequences in that, on balance, they shift income from lower to higher income people. Other programs were found to be imposing significant and unaccounted for costs on low-income citizens. Several programs were seen to contain incentives which encouraged rising costs, inefficiency, and poor performance in that part of the private sector affected by the program. Serious problems of excessive costs were observed in a number of areas. In several cases, economists recommended that the Federal Government rely more heavily on beneficiary charges in the distribution of public outputs in order to eliminate the waste generated by the prevailing practice of giving them away.

In appendix 4, economic critiques of the programs studied by the subcommittee are presented. These discussions are abstracted from the statements presented by the economic experts appearing before the subcommittee. The Federal programs which were assessed in these case studies include—

1. Urban highway and urban renewal programs;
2. The medicare program;
3. Institutional aid to higher education;
4. Water resources, including navigation policy;
5. Water pollution policy;
6. The helium conservation program;
7. Maritime policy;
8. Aviation policy; and
9. Highway policy.

Although the subcommittee received several days of testimony on these programs and policy areas, we do not feel that we have studied them in the depth necessary to offer specific recommendations on any particular program. However, on the basis of the economic case studies presented to the subcommittee, we do have serious questions concerning program performance and serious misgivings concerning the efficiency and equity impacts generated by a number of Federal Government activities.

As is clear from a perusal of appendix 4, several common sources of program inefficiency and inequity were cited by witnesses in case after case. Here we shall but cite these recurring themes and emphasize the serious resource misallocation, and adverse distributional impact which they imply:

1. In planning and implementing programs, the Federal Government has often ignored the existence of powerful incentive, penalty, and reward structures. Neglect of these structures has fostered serious inefficiencies and performance shortfalls.[14]

2. The common practice of giving the benefits of public programs to particular individuals and groups free of charge has fostered serious overspending on some programs and has generated undue pressure for increased public support by those subsidized.[15]

3. Many Federal programs commonly depicted as providing public services to a wide cross section of citizens in fact channel most of their benefits to the rich and well-to-do at the expense of lower income groups. Other Federal programs impose enormous

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[14] In his testimony, Charles L. Schultze, former director of the Bureau of the Budget, strongly emphasized the serious consequences of ignoring incentives, penalties, and rewards:

"To a growing extent, public program performance depends upon the behavior of a large number of independent decisionmakers, public and private. Actions cannot be commanded. There is no hierarchy of officials in a single line of command who can be directed toward a set of predetermined objectives. In such cases the careful specification of plans and objectives by a public agency will not suffice to guarantee effective programs. The program must also be explicitly designed to provide incentives or inducements for the relevant decisionmakers outside the public agency to act in directions which are consistent with program objectives.

"For two reasons, the problem of incentives deserves particular attention in the formulation of public expenditure policy: first, because national objectives increasingly depend for their realization on the joint action of many independent decisionmakers, private as well as public; and second, because the growing complexity and geographical diversity of public programs requires decentralized decisionmaking within the public sector itself.

"An analysis of this problem from the standpoint of creating incentives for decentralized operators to pursue public objectives, suggests two ways of attacking this problem:

"Providing market competition for public programs.

"Imitating market conditions in public programs."

In his statement to the subcommittee Dr. Schultze cited serious problems of reverse and nonexistent incentives and penalties in Federal maritime policy, flood control policy, aviation policy, medicare policy, water pollution control policy, and institutional aid to higher education.

[15] In a statement to the subcommittee, one economist cited the need for beneficiary charges and user prices as follows:

"[Beneficiary charges have] three major purposes or rationale * * * (1) *Equity*—it is 'fair' to charge beneficiaries and not force the general public or nonusers to bear the burden; (2) *Revenue production*—most levels of government are strapped for funds and beneficiary charges could be used to supplement other revenue sources; and (3) *Efficiency*—beneficiary charges can promote efficiency in the use and production of public goods and services.

"Unless substantial payment for benefits is required from beneficiaries or from the jurisdictions in which they reside, the forces to 'discipline' public investment decisions will be very weak. Clearly, when the discipline of the market is absent, there are serious problems of how to obtain responsible public investment decisions. We lack measures to reward good decisions and to penalize poor ones."

See also the discussion of Federal institutional aid to higher education programs, water resource programs, water pollution control policy, aviation policy, and highway policy in appendix 4.

costs on low-income citizens which are neither compensated nor taken into account in program planning decisions.[16]

4. The trust fund formula allocation instrument, whereby about $60 billion of Federal program expenditures are financed and spent, generates budget uncontrollability, disguises program costs and benefits, eliminates the possibility of applying public expenditure criteria, and effectively removes the program from regular congressional scrutiny.[17]

In discussing these instances of inefficiency and inequity, witnesses stated that the prevailing congressional practice of carefully scrutinizing only the budgetary increments has contributed to the undesirable effects which have become incorporated into many longstanding public programs. Without periodic from-the-ground-up program reappraisal and "zero-base budgeting," these undesirable effects become built into programs and remain undiscovered for long periods of time. We find merit in this point and urge that the congressional committees with program responsibilities (including the Appropriations Committees) establish an explicit procedure whereby every Federal program receives comprehensive scrutiny and a zero-based reappraisal concentrating on objectives, organization, effectiveness, costs, benefits, and distributive impacts once every 5 years. An open reevaluation based on objective analysis and studies would eliminate the possibility that these inefficiencies and inequities would become buried in the past and remain undetected for years.

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[16] See the discussion of Federal urban highway and urban renewal programs, institutional aid to higher education programs, water resource programs, water pollution control policy, aviation policy, and highway policy in appendix 4.

[17] See the discussion of the medicare program and Federal highway policy in appendix 4.

Recommendations

10. Congressional committees with program responsibilities should establish an explicit schedule whereby all existing Federal programs would be subjected to a comprehensive, from-the-ground-up reappraisal at least every 5 years. This reevaluation would focus on the objectives of the program and its performance in meeting the objectives and should be based on study and analysis of the effectiveness and distributional impacts of the program. This recommendation would extend to the entire budget the periodic reappraisal procedure established for grant-in-aid programs by the Intergovernmental Cooperation Act of 1968 (Public Law 90–577, title VI).

11. Each executive department should be required to undertake a comprehensive study of the equity and distributive effects of the programs for which it is responsible. Each study should ascertain the extent to which individual Federal expenditure and rulemaking activities are channeling the bulk of their benefits to higher income classes and regions at the expense of lower income groups, as is indicated in several of the case studies presented to this subcommittee.

12. The trust fund should be abolished as an instrument for financing Federal programs involving investment, construction, or the provision of facilities or services. Congress should assume responsibility for annually financing each such Government activity at the level which its value warrants. The trust fund mode throws the budget out of control and effectively insulates programs from the effective congressional scrutiny which efficiency demands.

13. The Bureau of the Budget and the Council of Economic Advisers should undertake a major study of the structure of incentives, penalties, and rewards incorporated into Federal program formulation and execution and into the process of budget allocation. This study should take the form of a report to the Congress and should be the subject of special hearings by the Joint Economic Committee. In particular, this study should evaluate the potentiality of extending beneficiary and user charges as a means of distributing publicly produced outputs and controlling the use of common resources, with a view to establishing comprehensive and consistent Federal policy on this matter.

VII

The Performance of Federal Agencies With Regulatory, Rulemaking, and Compliance Responsibilities Should Be Critically Examined

In hearings on "Economic Analysis and the Efficiency of Government," the subcommittee inquired briefly into the economic performance and responsiveness of Federal agencies with regulatory responsibilities. On the basis of testimony presented by witnesses intimately acquainted with the regulatory process the subcommittee fears that there are serious problems of efficiency and effectiveness in the performance of these functions.

The activities of regulatory agencies include the establishment of rates and prices for some of the Nation's largest industries, the regulation of the organization of these industries, the management of publicly owned resources used by private interests, the certification or licensing of certain investments or developments, and the establishment and enforcement of rules guiding the provision of services by these industries.

All of these functions are economic functions and a decision taken by an agency on any one of them is likely to cause a significant reallocation of the Nation's resources and redistribution of its income. It goes without saying that the public interest will not be served if these decisions are taken without consideration or knowledge of economic or equity impacts or without explicit consideration of the range of alternatives for attaining a specific objective. Similarly, inefficiency will result and the public interest will suffer if the decision process is biased toward specific interests.

Because of the functions of the regulatory commissions, the size of their budgets is not a very useful measure of the impact of their decisions upon the national economy. Unlike most Federal agencies, they are not faced with difficult decisions involving the expenditure of billions of Federal tax dollars. Nevertheless, the economic impact of their activities is enormous. As one witness put it:

> The impact of this sector of governmental activities on the functioning of the economy and the efficiency of government is almost impossible to overestimate.[18]

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[18] Federal Communications Commissioner Nicholas Johnson described the economic impact of FCC decisions as follows:

"The use of the radio spectrum by private interests is estimated to add $20 billion to the GNP; the broadcasting industry grosses $3 billion annually; and the Commission is presently considering interstate telephone rates that could have a $500 million effect on user rates paid for interstate service alone, not to mention the impact upon State regulatory commissions. Thus, this little $20 million agency has a profound effect on the functioning of our entire society: the efficient use of a valuable natural resource, the quality and cost of our telephone network, and the ability of broadcasters to provide the information crucial to self-government by the people. A Commission failure to manage the radio spectrum efficiently can seriously affect economic development and lead to rates that are too high and impair the use of communications by users; or failure to assert public interest control over the broadcast industry may result in serious imbalances of power through the society or in particular communities where media concentrations can threaten the democratic process."

In our hearings, several assertions regarding the rulemaking process and the effectiveness of its performance were emphasized. While the subcommittee did not undertake a sufficiently comprehensive study to offer a firm critique of the efficiency of regulatory agencies, we wish to note the strong possibility of a serious performance shortfall in this area. The points stressed by the witnesses include:

1. The practice of making decisions only in response to a petition from outside and the lack of statutory authority constrains the regulatory agencies from considering a range of alternatives or adopting a comprehensive, economy-wide perspective.[19]

2. Regulatory agencies fail to undertake sufficient economic analysis of either the decisions which they make or the industries they regulate.[20]

3. No agency outside of the regulatory bodies, including the Bureau of the Budget, scrutinizes the effectiveness of regulatory decisions or subjects them to explicit economic and equity analysis.

4. The rulemaking process lacks a formal advocacy of the public interest position in the cases and issues on which it must make decisions.[21]

5. The regulatory agencies fail to recognize the substantial economic value of the common property resources which they are allocating and forgo the benefits from applying user or beneficiary charges both to recover this value for the public and to efficiently regulate the use of these resources.[22]

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[19] Lee C. White, former chairman of the Federal Power Commission, described this situation as follows:

"In many regards, regulatory agencies are organizations with limited initiative or choice as to how their funds will be spent. * * * In short, the agencies are primarily reactors, not initiators. I am convinced that reasonable sums devoted to * * * broad, non-adversary inquiries produce far more meaningful results than the dollars devoted to the more traditional case-by-case approach. * * * In the case of some regulatory agencies, it may be desirable to determine whether additional statutory authority is required if the agency is to make a real contribution to the process by which economic and physical resources are to be allocated."

[20] Nicholas Johnson described the analytical interest and capability of the Federal Communications Commission in the following terms:

"There is no central planning unit in the [Federal Communication] Commission's organization * * *. There is at best only limited recognition of the desirability of specifying *all* alternatives—and little capacity to evaluate them when presented to the agency from outside * * *. There is not one economist on the Commission's staff who is at all concerned with the spectrum allocation and management function * * *. [The] Commission views solicitation of the views of outside economic interests as a *substitute* for internal research and analysis * * *. The Commission may affect Bell's decisions through a variety of regulatory policies, but it is almost completely unaware of their impact."

[21] The lack of a formal public interest advocacy was emphasized by both Mr. White and Mr. Johnson. They stated, respectively:

"What needs to be done, in my view, is to insure that the decisionmakers [in the regulatory agencies] have available the most effective advocacy of all points of view. Thus, I have supported [the establishment of] a Consumers' Council who would be paid tax funds to present the case of the consumers in all proceedings before regulatory agencies."

"The Commission tends to think of itself as a court, reacting to those matters that are placed before it only in terms of the information from interested parties pursuing their own economic interests. There is at best only limited recognition of the desirability of specifying *all* alternatives—and little capacity to evaluate them when presented to the agency from outside."

[22] Again, both Mr. White and Mr. Johnson emphasized this point. Their respective statements are:

"[L]icenses or certificates * * * are items of considerable value to the licensees. * * * Simply having the right to build and operate a television station in a major metropolitan area is a right worth millions of dollars. Similarly, airline routes * * * have great intrinsic value. The FPC frequently has competing applications to serve identical markets by more than one pipeline, because of the great profitmaking potential that those certificates represent.

"Countless suggestions for increasing the amount paid for these rights have been made in the past * * I certainly believe that enough studies, surveys, and reviews have been

6. Federal agencies responsible for assuring compliance with laws and regulations are understaffed and, more significantly, lack interest in determining and revealing the serious extent of noncompliance with Federal laws and rules.[23]

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made and it is now time for the Bureau of the Budget to propose changes and for the Congress to act."

"The Commission has made almost no use of market simulating techniques, such as user fees in its allocation process. * * * We have simply made frequencies available to those who asked, when they asked, and some get unduly congested and others are really underutilized."

[23] In his testimony before the subcommittee, Mr. Ralph Nader asserted:

"Limited compliance manpower has been used as the basis for antianalysis, for an obstinate reiteration of inaction and a shallow justification for a noncompliance policy for many activities under regulation.

* * * * * * *

"The need for regular compliance surveys is obvious. They help evaluate the cost-benefit effectiveness of available sanctions which the agency is empowered to apply. * * * At the present time, there is every indication that most regulatory agencies consciously avoid making such compliance surveys. * * * The reason for such lack of agency interest in conducting compliance surveys of its enforcement activity is the massive amount of illegality which it would have to recognize under its jurisdiction. Most agencies are not willing to reveal the extent to which their regulations are not being enforced or the extent to which these agencies are condoning, and often ignoring, the most blatant violations.

"* * * [A] few examples [of such violations include] (*a*) the systematic violations of the motor carrier safety regulations by interstate bus and truck companies, (*b*) widespread violations of the already weak railroad safety regulations, (*c*) the dozens of violations of the 1968 and 1969 motor vehicle safety standards by the automobile companies, (*d*) the dozens of tire failures to meet Federal standards uncovered but not moved against by the National Highway Safety Bureau, (*e*) the tragically shocking fraud that has permitted false claims and gross violations of the Federal motor vehicle pollution standards, and (*f*) the rampant violations of wholesome meat and poultry standards."

Recommendations

14. To eliminate the serious shortfall in the evaluation of the economic effects of Federal rulemaking activities, those agencies with regulation and compliance responsibilities should substantially expand their capability to undertake such studies and analysis. To the extent that decisions by these agencies reallocate resources or redistribute income, they should be subject to the same kinds of efficiency, equity, and pricing criteria as direct expenditure decisions.

15. Although the subcommittee study of Federal rulemaking policy was too cursory to warrant firm conclusions, we believe that there are large benefits to be achieved by a full-scale congressional study of the performance of the regulatory agencies. Congressional scrutiny of the decisions made by these agencies should be increased to insure that the full range of alternatives pertinent to any decision is considered. In particular, the consistency of regulatory decisions with the employment and growth objectives of the Full Employment Act of 1946 should be explicitly appraised.

Appendix 1

The effectiveness of the primary components of the planning-programming-budgeting system was described to the subcommittee by Dr. Jack Carlson, Assistant Director of the Bureau of the Budget for Program Evaluation, as follows:

1. The process of explicit *identification of major issues* * * * sharpens and focuses the general quality of discussion and debate between the various levels of management within each agency and between the Executive Office of the President and the agencies. It also aids the Budget Bureau in performing its functions during the planning and budgeting cycle.

2. The Program Memorandums (PM's) have been of uneven quality. Most of them have contained useful information, but only about 25 percent could be judged as adequate to excellent. Most of the others have not identified major alternatives, have not concentrated on policy decisions, or have not presented a multiyear strategy directed toward specific objectives and outputs. Many of the PM's tend to be descriptive, verbose, nonanalytic accounts of existing and proposed programs, together with an impassioned plea for funding at the full request. This is not very helpful in making resource allocation decisions, since it is difficult to know if an "urgent necessity" is more important than a "dire national need," a "must expenditure," or a "vital responsibility."

PM's have become important sources of program information at all levels in the executive branch because they do give a summary of information related to specific issues within an objective-oriented program category, something that seldom existed before. Where there has been a wide involvement of agency staff in preparing each PM, the broad educational gains for executives and subordinates in itself may have made the exercise worthwhile.

3. *Special analytic studies* have been a successful part of the PPB innovation. There is no complete census of the number and results of analysis of studies, but good ones have been done and have been inputs into major policy decisions. In some cases, public policy bargaining has been sharpened and needless friction avoided because of revealing analysis. The preferences and judgments of the decisionmaker have been applied more knowingly than would otherwise have been the case.

4. The *Program and Financial Plan* has been useful to a few agencies and to the Budget Bureau. It has helped to provide some perspective on the level of committed public funds in the future, and even a modest improvement in this area represents progress. By knowing this, public executives can exercise more discretion over future budgeting than they would otherwise. It has also been useful for identifying unforeseen growth of seemingly uncontrollable expenditures.

Appendix 2

PUBLIC LAW 801—CHAPTER 730

84TH CONGRESS—2D SESSION

H.R. 10368

AN ACT

To amend the Civil Service Act of January 16, 1883, so as to require that certain reports and other communications of the executive branch to Congress contain information pertaining to the number of civilian officers and employees required to carry out additional or expanded functions, and for other purposes

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the Civil Service Act of January 16, 1883, is amended by adding at the end thereof the following new section:

"SEC. 11. (a) Each report, recommendation, or other communication, of an official nature, of any department, agency, or independent establishment of the executive branch of the Federal Government (including any corporation wholly owned by the United States) which—

"(1) relates to pending or proposed legislation which, if enacted, will entail an estimated annual expenditure of appropriated funds in excess of $1,000,000,

"(2) is submitted or transmitted to the Congress or any committee thereof in compliance with law or on the initiative of the appropriate authority of the executive branch, and

"(3) officially proposes or recommends the creation or expansion, either by action of the Congress or by administrative action, of any function, activity, or authority of any such department, agency, independent establishment, or corporation, to be in addition to those functions, activities, and authorities thereof existing at the time such report, recommendation, or communication is submitted or transmitted to the Congress or any committee thereof,

shall contain a statement, with respect to such department, agency, independent establishment, or corporation, for each of the first five fiscal years during which each such additional or expanded function, activity, or authority so proposed or recommended is to be in effect, disclosing the following information:

"(A) the estimated maximum additional—

"(i) man-years of civilian employment, by general categories of positions,

"(ii) expenditures for personal services, and

"(iii) expenditures for all purposes other than personal services,

which are attributable to such function, activity, or authority and which will be required to be effected by such department, agency, independent establishment, or corporation in connection with the performance of such function, activity, or authority, and

"(B) such other statement, discussion, explanation, or other information as may be deemed advisable by the appropriate authority of the executive branch or which may be required by the Congress or a committee thereof.

*   *   *   *   *   *   *

(Approved July 25, 1956)

Appendix 3

ILLUSTRATIVE MANPOWER OVERVIEW DATA[1]

Programs (agency)	NOA[2] (millions), 1970 estimate	Expenses[3] (millions), 1970 estimate	Built-in growth to 1975[3] (millions)	Built-in growth to 1976 (millions)	Man-years, 1970, estimate	Average duration (weeks)	Participant unit cost: Allowance and subsistence	Participant unit cost: Other	Participant unit cost: Total Government[4]	Participant unit cost: Private[5]	Participant unit cost: Total
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
On-the-job training	$596	$398			180						
MDTA regular (Labor)	64	66			37	20					
JOBS (Labor/OEO)	438	256			89	24					
PSC (Labor)	50	33			11	24					
Veterans' OJT (VAO)	40	40			42	21					
Indian OJT (Interior)	4	4			1	15					
Institutional training	440	455			90						
MDTA	229	240	240	240	60	18	780	650	1,430	((170)	1,600
Job Corps	180	188	205	205	22	24	990	3,010	4,000	((640)	4,640
Indian training	31	27			8	36					
Work support	337	334			174						
NYC out-of-school (Labor)	103	102	102	102	34	20	825	275	1,100	((0)	1,100
NYC in-school (Labor)	62	62			73	(28)					
NYC summer (Labor)	121	120			53	(8)					
Operation Mainstream (Labor)	41	41			10	34					
Foster Grandparents (HEW)	9	9			4	42					
Comprehensive	896	837			682						
Vocational rehabilitation (HEW)	500	460	500	500	497	53	85	1,115	1,200	690	2,090
Veterans' vocational rehabilitation (VA)	38	38			12	24					
Work incentive (HEW)	130	148			135	(36)					
CEP (Labor/OEO)	209	178			35	(16)					
Title V, MDTA	20	13			3	18					

See footnotes at end of table, p. 41.

ILLUSTRATIVE MANPOWER OVERVIEW DATA [1]—Continued

Programs (agency) (1)	NOA [2] (millions), 1970 estimate (2)	Expenses [2] (millions), 1970 estimate (3)	Built-in growth to 1975 [3] (millions) (4)	Built-in growth to 1976 (millions) (5)	Man-years, 1970, estimate (6)	Average duration (weeks) (7)	Participant unit cost: Allowance and subsistence (8)	Other (9)	Total Government [4] (10)	Private [5] (11)	Total (12)
Labor market adjustment	459	459									
Employment service (Labor)	373	373									
CAP manpower	17	16									
Equal employment opportunity (EEOC)	16	15									
Project Transition	18	18									
Indian mobility	8	10									
Project 100,000	27	27									
Research and development	23	24									
Other, including overall administration	76	75									
Total	2,828	2,582			1,126						
Total tax expense											
National distribution											

Programs (Agency) (1)	Benefit values: Trainees' average annual wage gain [6] (13)	Add to net national income [7] (14)	Benefit-cost ratio [8] (15)	Income transfer [9] (16)	Enrollee characteristics (percent): Household income [10] 3,500– —3,500/10,000/10,000+ (17)	Age 21– —21/55/55+ (18)	Education —8/11/12+ (19)	Race W/NW (20)	Location [11] 500K CC/Sub/Urban Other/Rur (21)	Redirection potential [12] (22)
On-the-job training										
MDTA regular (Labor)										
JOBS (Labor/OEO)										
PSC (Labor)										
Veterans' OJT (VAO)										
Indian OJT (Interior)										

Institutional training											
MDTA	((700)	((3,097)	((2.9)	((780)		65/30/0	40/58/2	11/53/36	50/50	(46/26/18/10)	5
Job Corps	((800)	((1,995)	((1.4)	990		97/3/0	100/0/0	15/80/5	32/68	40/10/33/17	7
Indian training											
Work support											
NYC out-of-school (Labor)	((190)	((775)	((1.7)	(825)		97/3/0	100/0/0	12/81/7	50/50	(28/8/16/48)	7
NYC in-school (Labor)											
NYC Summer (Labor)											
Operation Mainstream (Lab)											
Foster Grandparents (HEW)											
Comprehensive											
Vocational Rehabilitation (HEW)	2,000	((11,330)	((6.4)	(85)		(73/22/5)	24/64/12	(21/41/38)	76/24	((46/26/18/10)	5
Veterans' vocational rehabilitation (VA)											
Work incentive (HEW)											
CEP (Labor/OEO)											
Title V, MDTA											
Labor market adjustment											
Employment Service (Labor)											
CAP manpower											
Equal employment opportunity (EEOC)											
Project Transition											
Indian mobility											
Project 100,000											
Research and development											
Other, including overall administration											
Total											
Total tax expense											
National distribution						21/49/30	41/41/18	33/18/49	88/12	22/21/27/30	

1 Parentheses indicate estimates are tenuous. Double parentheses indicate estimates have high potential range of error.
2 Contained in revised 1970 budget request as of May 9, 1969.
3 Expenditure level in fiscal year 1973 necessary to fund program on an annual basis under current program levels and policies.
4 Includes Federal, State, and local.
5 Usually measures enrollees' foregone earnings net of allowances; for on-the-job training, measures employers' costs.
6 Estimated value of average increase in annual earnings as a result of participating in the program.
7 Benefits to net national income is net value of benefits; specifically, (a) discounted value of future earnings increase +(b) value of work performed —(c) social costs.
8 B/C denotes efficiency benefit/cost ratio, specifically (a) present discounted value of enrollees' annual wage gain (discounted over 10 years at 10 percent +(b) value of work performed —(c) social costs, including enrollees' foregone earnings.
9 Value of cash or in-kind consumption items per participant while engaged in program.
10 —3,500 denotes in poverty category; 3,500–10,000 denotes family income between poverty and $10,000.
11 500K CC denotes central city of SMSA with 500,000 population or more; 500K sub denotes corresponding suburbs; other urban denotes all other urban areas; rural denotes all areas with less than 2,500 population.
12 Index of potential for redirection of program to specified target groups on scale of 1 to 10. Programs with low potential for redirection (formula grant programs) would be rated low, while those with high potential (operated directly by Federal Government) would receive high rating.

Appendix 4

The following paragraphs abstract the case studies of particular programs and policy areas presented to the subcommittee by economic experts. The conclusions and recommendations are to be attributed only to the witnesses.

1. Urban Highway and Urban Renewal Programs

The economic critique of Federal urban programs concentrated on the Urban Renewal and Federal Highway programs. Both of these programs involve major land clearance and construction activities in the congested "central city" areas of most major U.S. urban centers.

Dr. Anthony Downs, vice president, Real Estate Research Corp., argued in his testimony that Federal planning in this area has failed to consider major elements of cost in design, compensation, and program implementation decisions. Because of this neglect of costs, serious inefficiencies and inequities have been created by these programs. The following were cited as basic causes of this problem:

a. The tendency of Federal agencies to define the effects of projects too narrowly so as to improve the chances of congressional adoption;

b. The tendency of analysts to focus only on economic variables and to assume the existence of free market conditions in urban housing markets; and

c. The failure of Federal policy to provide compensation for many costs which get imposed on citizens by federally sponsored activity.

As examples of this neglect of real costs in program planning, Dr. Downs cited the case of Federal highway construction in Baltimore, which from 1951 to 1964 destroyed the equivalent of 21 percent of the entire housing inventory "of low income Negroes." He estimated that "the total non-compensated cost of these and other injustices resulting from both federally financed highways and federally financed urban renewal projects will amount to somewhere between $156 and $230 million per year in the next few years. About 237,000 displaced persons and another 237,000 nondisplaced persons per year will be affected. This amounts to a potential non-compensated loss of from $812 to $1,194 per household affected—or from 20 to 30 percent of the average household income of those concerned. If the Government paid the full costs involved, this would add 14 to 21 percent of the total costs of acquiring all the real property concerned. Hence the magnitude of the injustices arising from such narrowness of viewpoint is hardly trivial. Rather it is huge."

2. The Medicare Program

The cost of the medicare program in 1968 was $3.8 billion, financed by payroll taxes through the Social Security Trust Fund. This program pays the hospital costs of a significant share of the Nation's population. Built into the program is a reimbursement scheme in which hospitals are *fully* reimbursed for the costs incurred in treating Medicare patients.

A serious inflation in hospital costs has coincided with the first few years of the medicare program. In both 1966 and 1967, hospital costs rose by over 16 percent. Average per diem hospital costs are now $60 and are projected to rise to $100 in 5 years. In addition to this increase in per day costs has been a significant rise in the rate of hospital use by the population in recent years.

Two economists appearing before the subcommittee discussed the structure and impacts of the Medicare program. They are Dr. Vincent Taylor of the RAND Corporation and former Director of the Bureau of the Budget Charles L. Schultze. Both of them concluded that the reimbursement formula incorporated into the medicare program has fostered unnecessarily high hospital costs and imposed a substantial unnecessary burden on U.S. taxpayers.

In the testimony of Dr. Taylor, the existence of substantially lower hospital costs borne by subscribers to a large, prepaid health plan in the Western United States was documented. This plan owns and operates its own hospitals. Through excellent management practices, the hospital costs for people in this plan were from 25–40 percent below the hospital costs for California citizens as a whole.

Dr. Taylor also noted that a sizable portion of these lower costs was due to the lower use of hospital beds by members of the plan than by California residents generally. This data provides some indication of the cost saving possible if appropriate incentives for cost reduction were included in the medicare program.

The analyses presented to the subcommittee concluded that:

a. The medicare reimbursement formula includes *no* incentives for hospital cost reduction. This phenomenon has contributed importantly to rapidly rising hospital costs.

b. U.S. citizens covered by payroll tax legislation (which finances the Social Security Trust Fund) are bearing a large part of the burden of these rapidly rising hospital costs.

c. U.S. citizens owning private hospitalization insurance or making use of hospital care not covered by insurance also sacrifice income because of the rapidly rising hospital expenses.

d. The beneficiaries of the increased costs are primarily the employees of hospitals, including physicians, and the suppliers of material inputs to hospitals.

e. The Department of Health, Education, and Welfare has taken little, if any, action to experiment with improved incentive arrangements or other procedures to stimulate economy in hospital management.

3. Institutional Aid for Higher Education

Recent study has shown that the children of people with high incomes tend to receive better quality higher education than do the children of the poor. Research has also shown that many higher income people receive large subsidies by means of public grants provided to institutions of higher education.

Current Federal policy includes many programs of subsidies to institutions as opposed to grants and loans to students. Among the institutional aid programs are the college housing loan program, grants and low interest loans for academic facilities, and grants for the purpose of purchasing science education facilities, library resources, instructional equipment, computers, and health education equipment.

Dr. Roger Bolton, associate professor of economics at Williams College, analyzed the income distribution and efficiency effects of alternative forms of Federal aid to higher education in testimony before the subcommittee. He concluded that institutional aid to higher education is distinctly inferior to the direct provision of loans and grants to students or families with college students. The reasons offered in support of this conclusion are:

a. When the Government subsidizes institutions (as opposed to people), it loses control over the income levels of the students who actually benefit. This control passes to the institution.

b. Subsidy given directly to the institutions is relatively unproductive in generating increased production of higher education services. Much of the subsidy is absorbed in higher costs for the same inputs rather than contributing to the purchase of more or better inputs or increasing the number of students in attendance at these institutions.

c. When institutions are directly subsidized for purchasing certain kinds of inputs, as in categorical grants, an incentive is established to design programs in ways in which the institution itself would regard as nonoptimum, if they were free to spend money as they pleased.

d. Institutional aid tends to be used as a substitute for tuition and becomes, in effect, "a disguised *cash* subsidy heavily favoring upper income groups."

4. Water Resources, Including Navigation Policy

In fiscal year 1969, the Federal Government expended over $2.2 billion to construct, operate, and maintain irrigation, navigation, and flood control facilities. The benefits produced by these undertakings are typically provided to the beneficiaries at either a zero price or at a price which fails to cover the full costs of the undertaking. In nearly all flood control projects, the Federal Treasury covers well over 50 percent of the project cost and often U.S. taxpayers pay close to 100 percent of the cost. All water resource projects approved by the Congress are subject to benefit-cost analysis as required by the Flood Control Act of 1936.

During the course of the subcommittee hearings, two witnesses discussed the economics of current Federal water policy. They are Dr. Mason Gaffney, professor of economics at the University of Wisconsin-Milwaukee, and Dr. James R. Nelson, professor of economics at Amherst College. They emphasized a number of characteristics of Federal Government policy which, in their judgment, foster resource misallocation and inequity. The following practices were cited as major problems which generate undesirable economic impacts:

a. The "giving-away" of public resources. Water rights and damsites have been assigned to individuals and businesses free of charge for indefinite tenure.

b. The use of inappropriately low discount rates to appraise Federal projects.

c. U.S. tax policy which permits the expensing of losses on premature development and fails to tax the appreciation of land values.

d. The congressional "log-rolling" practice.

e. The failure to impose user charges for the use of congested facilities.

f. The use of ambiguous and hypothetical traffic surveys to estimate the potential output of navigation facilities.

Because of these practices and policies, the witnesses discerned the following wasteful or inequitable results from Federal activity in water resource development:

a. The relaxation of "pressure to put resources to their best use."

b. The premature and presumptive development of the Nation's water resources which results in public investment which runs ahead of complementary private land development.

c. The generation of inflationary pressure because of the slow payout which "[creates] demand without supply."

d. The fostering of an unequal distribution of income because the benefits of these undertakings accrue to the "very, very, very rich."

e. The generation of problems of congestion on water-courses due to the failure to employ specific user charges.

5. Water Pollution Control Policy

The present strategy of the Federal Government in reducing the level of water pollution is embodied in the Federal Water Pollution Control Act of 1965. This strategy included (1) Federal financial support in the form of grants to municipalities for the construction of sewage treatment plants, and (2) federally required State water quality standards. These required standards are now in effect.

In the Water Pollution Control Act of 1966, over $3.4 billion worth of municipal grants were authorized for 1968–71, although only a small fraction of this has been appropriated. Through this program, municipalities can cover up to 55 percent of the costs of waste treatment plant construction by Federal grants.

The strategy of providing Federal financial aid for waste treatment has been continued in the recently enacted tax reform bill. It provides "tax expenditures" of nearly $400 million (through 1974) for *industrial* waste treatment facilities through a 5-year amortization provision.

Dr. Allen V. Kneese, Director of the Quality of the Environment Program at Resources for the Future, Inc., presented a critique of current water pollution control policy to the subcommittee. This policy area was also discussed in the statement of Dr. Charles L. Schultze. They concluded that the current subsidy-enforcement strategy is inefficient, ineffective, and inequitable. The reasons offered for this conclusion are as follows:

a. The polluter of public resources—for example, watercourses—should be forced to bear the social cost of destroying or reducing the value of these resources. Unless he is forced to bear the cost, he has little incentive to alter his behavior so as to reduce the volume of wastes produced by his activity. Federal grants or tax subsidies are unable to generate these appropriate incentives. Similarly, administrative rule enforcement is a crude instrument by which to encourage changed behavior. A system of charges imposed on polluters who use the waste assimilative capacity of streams would provide such incentives and, in addition, would provide revenue for further measures to improve the quality of water.

b. A subsidy for treatment plant construction provides a weak incentive for *treating* wastes. This is so because even a substantial subsidy of 70–80 percent of the cost of treatment facilities fails to make treatment plant construction a cheaper alternative than dumping untreated waste into watercourses. Moreover, it provides little if any incentive for altering production processes so as to reduce the creation of waste products.

c. Current policy requires that the cost for improving water quality be borne by U.S. taxpayers, rather than by those who are polluting the rivers. This approach also places a serious added strain on the budget and, in all likelihood, leads to a more inequitable distribution of the burden of pollution costs than an alternative strategy.

As an alternative to existing policy, the levying of *effluent charges* on polluters combined with a series of regional water quality management agencies was proposed and detailed.

6. The Helium Conservation Program

Since 1960, the Federal Government has administered a program to store helium, an inert gas which is available at low cost as a byproduct of natural gas production in Oklahoma and Texas. At the time the program was initiated, it was judged that, upon exhaustion of the natural gas source, no reasonably low-cost source of helium would be available. Hence, the storage and conservation motive which forms the basic rationale of the program.

The 1960 act enabled the Secretary of Interior to enter long-term contracts to buy helium and to sell it at prices which would recover costs, including interest. By 1961, contracts for the $47.5 million per year program (or $1.45 billion over the 22 years of program life) had been made. Information in 1960 implied that the revenues from the program would cover costs and that, on an economic basis, social benefits would exceed social costs.

In his statement, Dr. Lee Preston, The Melvin H. Baker Professor of American Enterprise at the State University of New York at Buffalo, presented a benefit-cost analysis of the current economics of the helium conservation program. This analysis concluded that a number of significant demand and supply changes have occurred since 1960 which indicate that further purchases and storage of helium would be an inefficient undertaking. The changes include:

a. The rise in interest rates in recent years has generated a significant increase in the cost of holding helium for use in future years. At a 4-percent interest rate, the cost of $12 (in 1969) for helium not used until 30 years from now rises to $40 (in 1999). However, if the discount rate is 10 percent, as now required by the Bureau of the Budget, the $12 cost (in 1969) rises to $200 after 30 years. This means that storing helium today for use in 30 years would only be efficient if it is expected that recovery of helium in 1999 will exceed a unit cost of $200.

b. Because of new technology and prospective natural gas sources, it appears that helium will become available from leaner sources at substantially reduced costs in the near future. These developments were not anticipated in 1960.

c. The recent demand for helium has fallen 20–30 percent below that projected in 1960. In part, this is due to the reduced needs of the Federal space program. Because of shortfall in helium purchases, the revenue necessary to repay the costs of the program has not been forthcoming.

d. Because of the Government's need to raise prices to recover costs, private helium producers have appeared and have competed away much of the market from the Government program through charging prices which are lower than those of the Bureau of Mines.

The changing supply and demand conditions have radically altered the economics of the Federal helium program. Dr. Preston concluded:

> * * * [S]ystematic analyses of the costs and benefits involved in the helium conservation program suggests that additional purchases for storage should cease as soon as possible and the economic resources that might have been used for these purposes diverted to other more productive activities.

7. Maritime Policy

Current Federal maritime policy provides substantial subsidies and preferences to U.S. shipping and shipbuilding enterprises. The cost of this complex of policies to U.S. citizens is over $700 million per year and is accounted for by a series of direct and indirect subsidies which affect nearly every aspect of the industry's activity. The effect of this policy is reflected in higher Federal expenditures and taxes and higher freight rates paid by U.S. citizens. The principal characteristics of current U.S. maritime policy are:

a. The operating subsidy.—The Merchant Marine Act of 1936 provides a subsidy to a select group of 15 U.S. ship operators equal to the difference between the labor costs which they incur and the labor costs which would be incurred by foreign ship operators. Currently this outright Federal subsidy amounts to about $190 million per year. Because of this provision, any increase in the wage costs of American ship operators is automatically paid for by U.S. taxpayers through increased Federal Government subsidy payments. Consequently, there is no pressure on ship operators to reduce their costs. Largely for this reason, the size of the subsidy has been increasing by over 4 percent per year.

b. The construction and repair subsidy.—The ship operators who receive the operating subsidy are also subsidized for the construction and repair costs on their vessels. These shipowners are paid the difference between the cost of a new ship built in U.S. shipyards and the cost of the same or comparable ship built in a cheaper overseas shipyard. This subsidy was about 35 percent of the cost of the shipbuilding two and three decades ago, but because of the increased cost of U.S. shipyards, has risen to 55 percent. The cost of this subsidy to U.S. taxpayers is about $125 million per year.

c. Indirect subsidies.—Other Federal laws, including the Cargo Preference Act of 1954, require that all peace-time military cargo and 50 percent of Agency for International Development and Department of Agriculture cargo must move on U.S. flag ships. Because of the substantially higher costs of shipments in U.S. bottoms, the shipping costs paid by U.S. Government agencies is about $200 million per year higher than it would be if the most economical shipping arrangements were used. The Food for Peace budget alone is from $80–$90 million higher than if lower cost shipping services were purchased. In a submission to this subcommittee, the Agency for International Development stated:

> Section 901(b) of the Merchant Marine Act of 1936 requires that at least 50 percent of the value of AID-financed commodities be carried on U.S. ships. This constrains sound economic analysis and limits full consideration of alternatives in a number of ways. The additional shipping cost of using U.S. bottoms, of course, reduces the net benefit of U.S. aid. The varying cost effect on different U.S. commodities also tends to distort the pattern of purchases which would otherwise take place. Low cost bulk exports, for example, such as fertilizers or coke, are discriminated against partly because the 50–50 restriction is one of the factors that tends to make U.S. goods noncompetitive, which in turn raises the costs of additional policies and interferes with future commercial exports. Since the purpose of section 901(b) is to assist the U.S. shipping industry, the charge should really be to that purpose and not to foreign aid.

d. Domestic trade monopoly (cabotage).—Existing legislation forbids the use of foreign ships in domestic trade. Because these ships are operated at substantially lower costs than are U.S. ships, U.S. citizens are required to pay higher shipping rates than they would otherwise. These premium rates cost U.S. consumers over $15 million per year.

Dr. Leonard Rapping, associate professor of economics at Carnegie-Mellon University presented testimony to the subcommittee on the economic impacts of U.S. maritime policy. He argued that enormous resource misallocation was resulting from existing policy. The following points summarize his conclusions:

a. Existing policy is commercially oriented rather than being designed to provide military capability benefits.

b. The needs of the military for merchant marine type shipping capability could be obtained at a fraction of the current cost to citizens.

c. The operating subsidy for labor costs has led ship owners to use far more labor than necessary and, in fact, relatively more labor than shipping nations with an abundant, cheap labor supply.

d. The operating subsidy for labor cost gives operators no incentive to cut operating costs relative to those of foreign competition.

e. The effect of the restriction of foreign competition and subsidy arrangements has been to seriously erode the efficiency of U.S. shipping relative to that of foreign ship operators.

f. The nature of the shipbuilding subsidy and the constraints on foreign ship purchases (together with an assured U.S. Navy demand) has rewarded inefficiency in the U.S. shipbuilding industry.

8. Aviation Policy

The anticipated growth of aviation in the United States is enormous. In the words of the economist who testified on this matter before the subcommittee: "Combining the three categories of flying (air carrier, general aviation, and military aviation) reveals a fantastic rate of growth of demand on FAA facilities. Total operations at FAA airport traffic control will more than triple over the next 12 years."

Nearly $15 billion has been requested by the administration for the next 10 years for airway facility investment, airport development, system operation, and research and development. Because of this rapidly rising demand, it is urgent that Federal aviation policy concentrate on achieving efficiency in both operation and development.

The following issues of policy planning were raised in testimony received by the subcommittee from Dr. Gary Fromm of the Brookings Institution:

a. Standards of measuring aviation safety now used by the FAA are erroneous and should be revised so as to enable the agency to evaluate alternative means of increasing safety.

b. While the rapidly increasing demand has created serious congestion problems, the FAA has failed to take appropriate economic pricing action to regulate the use of capacity.

c. The FAA has failed to require that the users of airport facilities bear the costs of providing and maintaining them. This has resulted in inefficiency in facility use and inequity in the allocation of the cost burden.

d. Even where charges have been (or are proposed to be) imposed on users, cost recovery has been incomplete and general aviation has borne virtually no costs at all. In the words of the witness: "[This policy] is especially unjust because general aviation users have significantly higher incomes than air carrier passengers and the general public. * * * [Moreover,] the impact on the demand for FAA facilities and resource allocation distortions is far more serious. Because general aviation use of FAA air navigation and control services is subsidized, its demand is greater than is economically or socially justified. This greater use causes congestion, which in turn leads to increased FAA outlays for more facilities, and yet larger subsidies. In part, the tremendous growth of this segment of aviation can be explained by the failure to confront these users with the costs incurred in their behalf. I am afraid that if this situation continues we will have the same waste, inefficiency, accidents, and chaos in the air as we now suffer on the Nation's highways."

9. Highway Policy

The Federal highway program is financed by the highway trust fund. The moneys for this fund accumulate automatically from the revenue generated by the Federal gasoline tax. The allocation of expenditures to the highway program is by formula and heavily favors rural areas. In fiscal year 1969, highway expenditures generated by the trust fund totaled approximately $4 billion.

In his critique of Federal highway policy, Dr. James R. Nelson, professor of economics at Amherst College emphasized the following points to the subcommittee:

a. The failure of Federal highway finance to rely on specific user charges or tolls will accentuate the problem of highway congestion and encourage the construction of uneconomic facilities.

b. The Department of Transportation is essentially prohibited from undertaking economic analysis of alternative transportation policies by the provision of section 4(b) (2) of the Department of Transportation Act of 1966.

c. The highway trust fund effectively insulates the highway programs from policy planning, economic analysis, and congressional scrutiny. It does so by (1) allocating funds by formula as opposed to an analysis of demand, benefits, and costs; and (2) requiring a total level of Federal expenditure based upon the past use of highways rather than the prospective demand which should be efficiently met.

Supplementary Views of Senator Charles H. Percy

The operation of Government in an efficient and effective manner is of critical importance today. In fact, there may be no action in the public sector which is more important. Congress can enact programs and appropriate money. The executive branch can administer programs and spend money. As daily experience indicates, however, there need be no correlation between such action and the accomplishment of desired or necessary objectives.

Protection of the taxpayers' interest is important. We must continually strive to prevent the waste of hard earned funds which taxpayers are required to pay to Government. To accomplish this goal, we must assure the sound allocation of economic resources and the efficient spending of that share of resources controlled by Government.

Today, we are faced with the potential destruction of our cities, the potential deterioration of our environment, the potential disorientation of our society. If we are going to preserve, safeguard, and advance our civilization, intelligent and sophisticated measures must be taken, including those that must be taken by Government using the modern tools of fiscal management and public administration outlined in this report.

As important as it is, however, for government to operate efficiently where it is authorized to operate, it is even more important that we recognize and appreciate the limits of Government.

In reading the first section of the report one is led to believe through implication or assumption that Government is more efficient than the private sector of the economy, that Government is better able to allocate economic resources, and that Government should thereby be given greater authority and control in the management of the economy.

I cannot accept this broad assumption and, frankly, I am rather surprised at the overly simplistic conception of public finance that the opening section of the report displays. The general sophistication of the committee's work as a whole and the commendable analysis contained in the balance of the report makes the illusionary benefits of Government operation that much more spurious.

Admittedly, Government must undertake many programs which might not otherwise be undertaken by the private sector. The assumption, however, that Government, in general, can perform or allocate resources more efficiently than the private sector, where the private sector is prepared to effectively operate, is open to serious challenge and refutation. This is so not because the private sector allocates and performs efficiently, but because little evidence exists that Government performs more efficiently. Certainly this report cites no specific examples to support this contention; rather, examples are limited to areas where the private sector does not seek or even presume to compete.

In fully supporting the desirability and need for Government to establish specific legislative objectives and to develop scientific measures to improve the efficiency of resource allocation, I believe that choice should not be limited to efficiency and equity among Government programs, as the report suggests. Instead, comparative analysis must be pursued between Govenment and the private sector.

Reference is also made to needed information flows. There is no question that much needed information—whether required by businessmen, consumers, or citizens in general—is lacking in the private sector and that such information is necessary if proper economic decisions are to be made or economic resources efficiently allocated. In many cases Government can and does make valuable information available to the public. But, contrary to the assumption or implication put forward in this report, can anyone state, in good conscience, that Government engages in or can be depended upon to engage in a free and open information policy? Have we so soon forgotten the credibility gap that we passed through in recent years? Even under the improved information policies of the present administration, I sincerely doubt that anyone can seriously consider placing upon Government an undue responsibility for informing the public as to the best means to efficiently allocate resources and to make other major economic decisions.

In spite of the above criticisms of the first section, the balance of the report constitutes a superb analysis of what needs to be done to make Government operate efficiently in those areas where it is determined that Government can operate more efficiently or can better allocate economic resources or can better provide welfare benefits. Similarly, the recommendations contained in the report are generally sound and supportable except for two.

While I certainly concur that Congress should create an Office of Economic Analysis to provide Congress with independent counsel and advice in economic and financial areas instead of forcing it to rely upon the executive branch or to operate in the dark, I believe such office should be nonpartisan beyond a doubt. It could of course be located within the Joint Economic Committee, as has been proposed. But such an office might better be established as a unit within the Legislative Reference Service of the Library of Congress or as a separate Senate-House unit analogous to the Office of Legislative Counsel.

The other recommendation I must fault is that calling for the abolition of trust funds. While I recognize that, in a theoretical emonomic and fiscal sense, such a recommendation has considerable merit, it lacks practicality in the real world in which we live.

Perhaps, if one were to start from scratch, the prohibition against trust funds might have merit. But, we're not in that state. Thus, as a result of the highway trust fund, billions of dollars have been spent for highways while only token grants have been made to urban mass transportation systems. The consequence, of course, has been to dangerously imbalance our transportation system—driving people from mass transit systems to highways and thereby increasing environmental pollution, economic and social dislocation, and urban deterioration. If we are to begin to equal the scales, a transportation trust fund will be required.

There are those who would argue that all this proves is that we should not have established a highway trust fund in the first place. Perhaps they are correct. Yet, knowing how misallocation of resources occurs and priority spending ignored, a failure to have created a highway trust fund in the first place might now mean that we would have an overall dilapidated transportation network with funds having gone for nontransportation uses. At least, as it is, we have one vastly improved mode of transportation over what it would have been otherwise. Then, too, let us recognize that we are not operating in a theoretical vacuum. The highways are built and more will be forthcoming. What would seem to be needed is not so much the termination of the highway trust fund, but its conversion into a transportation trust fund which would permit a more realistic (but earmarked) approach to governmental spending on transportation in order that we might be able to develop a balanced system.

One might also consider the social security trust fund. Does anyone seriously believe that is fiscally sound and essentially workable general social welfare fund would have been established in the 1930's or be in operation today if the trust fund concept were not utilized? Without the creation of the trust fund concept, funded in accordance with a specific formula, the social security program could have been starved for funds, or, in response to political logrolling, could have been driven into fiscally unsound waters.

A trust fund is certainly no economic panacea. In fact, it represents a somewhat primitive way for society to lay aside sums of money to fund programs deemed necessary and desirable. Yet, facing the political and social realities of life, the concept when properly used may provide the most effective means (at least in some cases) to allocate governmental financial resources.

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