The economic effects of expenditures are not generally independent of the means of financing them. For example, increasing individual income taxes tends to offset the increased consumer incomes (and subsequent expenditures) resulting from the payments to the factors of production made by the government contractors. Similarly, raising the corporate income tax reduces the funds available for the payment of dividends and for internal financing. Government borrowing operations may compete with private uses of funds.

There would also be a reciprocal effect on the public sector due to the government-induced expansion in the private sector. Unemployment compensation payments tend to decrease in periods when increased production, including government-ordered production, results in a lower level of unemployment. Also, increases in consumer and business incomes tend automatically to result in greater Federal revenues, especially with the existence of a progressive tax structure.

REDUCING GOVERNMENT SPENDING

In general, the effects on the economy of a reduction in spending are the reverse of the ones traced for the expansion of government expenditures. A curtailment of new obligational authority leads to a reduction in the volume of orders placed which in turn leads to a reduction in private production on government account. The end result is a reduction in government expenditures.

In practice, complicating factors will arise analogous to the ones examined in the preceding discussion of expansion in government spending. The very act of embarking upon a contraction of government activity can have an "announcement" effect on business and consumer anticipations. The exact nature of this response will vary with the surrounding circumstances.

Under circumstances of a large pent-up private demand for goods and services the curtailment of government demand may evoke waves of private buying of both consumption and investment goods. In other circumstances, the heralded decline in government purchasing may lead to a reduction in the total demand for the goods and services produced in the economy. Under such circumstances, announced reductions in government spending (as indicated by lower annual amounts of new obligational authority) will have a dampening effect on the private sectors of the economy in the absence of any large amounts of unsatisfied nongovermental demand.

Declines in new government orders and cutbacks and recisions of existing contracts have an immediate repercussion on business firms heavily dependent on government demand. Ackley has shown that in the case of a contraction in demand for production the crucial factor may be the length of irrevocable commitments to suppliers and to the factors of production.[51] However, if a seller has inventories which exceed what he feels to be the necessary minimum under the new circumstances, he can contract his production prior to the completion of his contracts (subcontracts from the Government's point of view) and can fill the balance out of inventory. Prompt settlement of contracts terminated by the Government helps to free working capital, to clear plants of special inventories and equipment, and to permit business to attain normal production patterns.

[51] Ackley, *op. cit.*, p. 361.