INCREASED GOVERNMENT SPENDING: A RECIPE FOR ECONOMIC STAGNATION, NOT STIMULUS

President Bill Clinton is considering proposals to increase government spending in an effort to stimulate the economy. The "stimulus" plan is said to include at least $15 billion of new spending, most of which would be designated for public works spending. But the most likely result of these higher federal outlays, regardless of how the money is spent, would be a drop in the economy's performance. Record increases in federal spending and budget deficits did not help the economy during the Bush Admininistration. There is no reason to think that expanding the size of government will work any better for President Clinton.

If higher federal spending and larger budget deficits could stimulate economic growth, the economy would be booming today. In the last four years, federal spending has increased by more than $340 billion. In this year alone, federal spending is expected to grow by more than $93 billion—not counting any spending which might be added by Clinton. The budget deficit, meanwhile, has jumped from $152.5 billion in fiscal year 1989 to a projected $327.3 billion for this fiscal year. Rather than grow, however, the economy in the last four years has experienced its weakest growth rate in more than fifty years. Nor has the increase in federal spending helped create jobs for American workers, the main goal of Clinton's planned stimulus package; unemployment climbed from 5.3 percent in 1989 to more than 7 percent today.

Outmoded Theory. The notion that higher federal spending generates economic growth is based on the Keynesian theory of economics, which was popular in the academic world prior to the 1980s. Under this theory, it is total private and government spending that determines the economy's performance, especially in the short term. If the economy slows, Keynesians believe that policy makers can restore growth by increasing the budget deficit and thereby boost total spending in the economy.

The Keynesian theory fell into disrepute in the 1970s when it became clear that high government spending and deficits were associated with slow economic growth and inflation—often called "stagflation"—and not with robust growth. Critics of the theory pointed out that, among other reasons, this was because Keynesians assumed that the money used for expanded deficit spending appears out of thin air. In the real world, however, every dollar of deficit spending requires the government to borrow one dollar from private credit markets. Rather than stimulate growth or increase total spending in the economy, deficits simply transfer resources from workers, consumers, and investors in the productive sector of the economy and put them under the control of politicians and bureaucrats. These officials tend to use the money less efficiently than the private sector would. The result: slower, not faster, economic growth and slower job creation.

If President Clinton approves $15 billion of additional deficit spending, this will simply crowd out $15 billion of private sector investment. The economy can benefit from this new federal spending only if government spends the money more wisely and efficiently than the private sector. World history suggests that is not very likely. Increased pork-barrel spending will please the interest groups on Capitol Hill, but it will not increase incentives to work, save, and invest.

Rather than increasing deficit spending, lawmakers should be slashing federal spending, so more of the nation's pool of savings will be available for investment in the productive sector of the economy. Private sector borrowing—which is used for such things as research and development, business investment, auto loans, and home mortgages—increases the economy's capacity to produce goods and services. And private investment makes possible the productivity increases that lead to rising wages and higher living standards for all Americans.

The Infrastructure Hoax. Clinton claims that spending increases will have a particularly beneficial impact if the money is spent on infrastructure. According to this theory, the economy's performance depends to a significant extent on how much taxpayer money is spent on roads, bridges, mass transit, government-financed research and development, education, and other programs that special interests have re-classified as public "investment."

The evidence is very clear, however, that higher spending in these categories will not stimulate job creation and economic growth. The General Accounting Office, for instance, discovered that each job created by the "Emergency Jobs Act of 1983" cost the economy $175,000 in today's dollars. A 1979 study by the Office of Management and Budget found that infrastructure jobs cost between $136,000 and $384,000. Since an average of $40,000 is needed to create each private sector job, any government program that uses more than $40,000 to create a job will actually reduce the total number of jobs in the economy. Besides being a net job-destroyer, scholarly research has found, additional infrastructure spending does not increase private sector productivity.

A Real Growth Policy. In order to stimulate economic growth, the Clinton Administration should copy the successful policies of John F. Kennedy and Ronald Reagan. Both Kennedy and Reagan triggered record economic expansions by slashing tax rates and reducing the burden of government spending. Both Kennedy and Reagan also favored free trade policies, resisting the siren song of protectionism. The pro-growth Kennedy and Reagan policies worked. The unemployment rate during the Kennedy expansion fell from 6.7 percent in 1961 to 3.5 percent in 1969, while Reagan's policies caused the unemployment rate to fall from 7.6 percent in 1981 to 5.3 percent in 1989.

Businesses are not charities; they create jobs when they expect that the revenues generated by an additional worker will exceed the total cost of employing that new worker, including government-imposed costs such as taxes and mandated benefits. If Clinton increases taxes, spending, regulation, and federal mandates, some existing jobs will be destroyed and fewer new jobs will be created.

Four More Years? Like Presidents Herbert Hoover and Jimmy Carter, George Bush undermined economic growth by increasing the burden of government. Bush reversed President Reagan's successful policies, ending the longest peacetime economic expansion in American history. Ironically, Clinton's economic platform—more taxes, higher spending, and increased regulation—signifies four more years of the same failed policies.

With federal spending already expected to increase by nearly $100 billion this year, the $15 billion of additional spending likely to be proposed by President Clinton will compound the damage already caused by a growing government share of the nation's economic output. Higher spending may produce economic growth on the university blackboards of Clinton's economic advisors, but it does not do so in the real world.

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For further information:

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Douglas Holtz-Eakin, "Public-Sector Capital and the Productivity Puzzle" (Working Paper No. 4122, National Bureau of Economic Research, Inc., July 1992).