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A Morality Play for New Spending?

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In both absolute numbers and as a percentage of the working-age population, more Americans are now at work than at any time in our history. Initially, this rapid rate of job creation—30 million jobs in 15 years—was accomplished by falling real wages. The good news is, that since 1983 real (inflation and tax-adjusted) wages have again been rising.

Liberal politicians and their court academicians have not been happy with the new prosperity. Dismayed by the low-inflation economic growth they neither created nor predicted, they have repeatedly attempted to focus attention on pockets of job loss in particular industries. And now that the Democrats have captured the Senate they have come up with a solution to the "job-loss" problem. Their "new idea" is yet more public spending, such as Sen. Paul Simon (D., Ill.) proposes in his "Full Employment Work Opportunity Act."

On the face of it this restoration of Jimmy Carter's economic policy would be laughable. But the Democrats are counting on two factors: short memories and their claim that higher government spending is a sign of caring.

Prosperity Breeds Great Ambitions

There's certainly considerable political logic to this. Consider the demographics: In 1988 there will be more than 30 million voters aged 18 to 25. So far, they don't vote as heavily as older voters, but if and when that changes—and a dramatic candidate with a dynamic message could change it—they will wield substantial clout. When Ronald Reagan was elected they were children, and they grew up on his political ideas. By 1988, young voters will be casting about for new ideas. Perhaps they will find them in something like the speeches of Hubert Humphrey and Robert Kennedy. Those speeches would sound like yesterday to older brothers and sisters in their 30s, but they would be positively crackling with newness for the voters of 1988 who were *born* in 1968.

As for those voters in their 30s—the baby boomers—they're the biggest demographic slice of all. They survived the '70s, thrived in the '80s and now, after enjoying a sustained period of economic growth and low inflation, may be ready to rekindle the fires of latent activism and pursue what might be called the luxury goods of public policy: massive new programs aimed at the poor and the unemployed. Prosperity breeds great national ambitions.

One thing liberals can rely on to argue their case is the moral argument they have always used when talking about high spending for social programs. At least we care, they say; at least we're helping the poor—even if it's costly, even if it's not the most efficient program in the world—at least we're trying.

Thus the liberals seize the moral high ground; and conservatives have always somehow ceded it to them, putting forth not a single argument save the libertarian's cry of, "But it's not yours to give," a statement that is (a) true and (b) utterly irrelevant to political realities. Conservatives seem content to play the role of checkbook balancer, dry little men with calculators adding up our fiscal sins.

But is the moral argument legitimate? Do liberals help the poor when they increase spending? We'd argue that high government spending in and of itself is highly destructive to long-run economic growth, and is therefore most harmful to the poor and those just starting out. In fact, substantial evidence suggests that as government spending grows as a percentage of GNP it reaches a point where additional amounts are more likely to increase economic misery than to alleviate it.

Initially, as government spending increases, economic growth increases. This spending provides the services that are essential for markets to operate and investment to take place—a judicial system for instance, and a national defense; we also include fundamental "public goods" such as the Centers for Disease Control and the FBI, which provide basic public health and safety. This kind of spending is necessary to create the conditions of stability in which economies flourish. (We would add that defense spending in particular needs to be high enough to give the citizenry a realistic feeling of security. By providing a defense umbrella for its allies, the U.S. also benefits from an increase in worldwide prosperity and security.)

So some spending is necessary—but only some. At some point the amount of spending begins to have a negative effect by slowing the economy's long-run growth. What accounts for the slowdown? Many things. Additional government services become less and less efficient in providing net benefits of real value, society's resources become less efficiently utilized, nonproductive behavior is increasingly rewarded and, of course, high levels of taxation and borrowing, necessary to continue the spending, destroy incentives for work, savings and investment.

When these things happen, spending reaches the point at which the economic ecology is upset. This might be compared to putting nutrients into a small fish pond—up to a point they make for bigger fish, but after that point they make for sick fish, and sometimes dead ones.

In general, countries where government spending was a relatively small share of GNP grew more rapidly than those where government spending was a relatively high share of GNP. For instance, economists James Barth (George Washington University), Robert Keleher (formerly, Council of Economic Advisers) and Charles Russek (Congressional Budget Office) in a preliminary study show a negative relationship between the size of government and economic growth in 27 out of 30 cases.

For example, Europe in the 1960s and 1970s boasted brisk economic growth. From 1965 to 1974 the Western European governments spent an average of 37% of their GNP—and economic growth stood at 4.3%. But the European leftists argued for more government spending to create jobs, and as a result, from 1975 to 1984, their governments' spending rose to an average of 47% of GNP—and economic growth slowed to a paltry 1.8%. The result in human terms? From 1974 to 1984 the major Western European economies suffered dramatic increases in the unemployment rate, averaging a stunning 152% increase in that 10-year period.

After European leftists argued for governments to create jobs, public spending rose to an average of 47% of GNP—and unemployment showed a stunning increase.

Obviously, other factors such as increased energy prices in the 1970s and the world recession in the early-1980s affected these economies. But Europe's continued deterioration after the vigorous recoveries of the less heavily taxed U.S. and East Asian economies suggests the primary problem is government absorption of resources (and high marginal tax rates).

But what is the flash point, the point at which good becomes bad, the point in the curve up to which we see economic growth and past which we see economic shrinkage? Preliminary analysis by U.S. Chamber of Commerce economists indicates that in OECD countries maximum rates of economic growth occur when government spending is about 15% to 25% of GNP and the slowest rates of economic growth occur—less than 2% average over a 10-year period—when government spending exceeds 45% of GNP. (Public spending in the U.S. now absorbs 36% of GNP.)

It is important to keep in mind not just the amount of spending but the kind of spending. Obviously, different programs have different impacts on the GNP. For instance, when the government spends money to build or repair the interstate highway system, and the economic benefits to the public from more rapid and lower-cost transportation exceed the cost, the spending will increase GNP growth. But if the government spends an equal amount of money on, say, transfer payments that discourage employment, the net impact on the GNP will be a minus, not a plus. It is both ironic and amazing that in spite of the obvious pertinence of the different effects of different spending programs, Congress persists in treating them all as if they were identical in effect.

What do we conclude? First, in spite of those who will discover increased spending as a new idea, the understanding that government spending can be destructive to continued prosperity will spread. In fact, we predict that measuring the precise economic impact of aggregate government spending—and of specific government programs—will be the major focus of economic policy in the coming years.

An Effective Answer

Also, since total U.S. government spending is already past the point where it increases economic growth, a moderate reduction in government spending will not only not cause a recession, it will enhance economic growth by reducing the government's claim on productive private economic activity. Again, however, defense spending cannot be reduced in a way that puts the country at risk, nor can government programs that protect basic safety and health. And reasonable transitions and provisions must be made to minimize hardships resulting from policy shifts.

Finally, back to the future—to 1988. Imagine a presidential debate. Imagine a Mario Cuomo moving us, despite our better logic, with a passionate plea to the better angels of our nature, a plea to recommit ourselves on a national level to massive programs to help the least of our American family, the hungriest at the national table.

One effective answer might be: "Ladies and gentlemen, my opponent supports a spending program that will lead to more poverty and more unemployment and that will require you to pay more taxes—and if you fail to pay them, he'll haul you before a judge.

"I ask you, what kind of man would have you thrown in jail for refusing to pay for a program that will increase poverty and unemployment in our country? Such a man may call himself many things—but 'morally superior' isn't one of them."

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