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KEYNES IS ALIVE, BUT NOT WELL, IN WASHINGTON

Opponents of a Balanced Budget Amendment assert that recessions will be deeper and more prolonged if the amendment prohibits the federal government from running budget deficits. According to this Keynesian article of faith, increases in federal spending relative to federal tax revenues expand total — government, household, and business — spending and thereby produce increases in total production, employment, and income.

Much of this increase in government spending and decrease in government tax revenues occurs automatically as the economy moves into recession. With falling output, employment, and income, payroll and income taxes decrease, while government outlays for such things as unemployment compensation and food stamps go up. These so-called "automatic stabilizers" allegedly cushion the decline in households' and businesses' disposable incomes, allowing them to maintain higher spending levels than they otherwise would be able to undertake. Moreover, according to this argument, the federal government should take action to increase other spending and/or to reduce taxes to fortify the automatic bolstering of disposable income.

Budget deficits will not maintain, let alone increase, real disposable income unless they result from fiscal actions that increase incentives for people to work, save, invest, innovate, start new businesses or expand existing enterprises.

The argument is wrong analytically. It is also rejected by history. It should be rejected by the Senate as the basis for deciding the fate of the Balanced Budget Amendment.

It is certainly true that the government's revenues automatically decline and certain of its outlays automatically increase during a recession. These automatic fiscal changes, however, don't — can't — increase total real spending. The resulting gap between government spending and government revenues has to be financed, either by the government's borrowing the difference or by resorting to the monetary printing press. If the government borrows the money to finance the deficit, the lenders' disposable incomes — the amount of their current after-tax incomes available to purchase consumption products or business assets — is reduced by the amount they lend the government — the same amount as the increase in the disposable incomes of other people. No net increase in income available for spending occurs.

The same thing is true if the government takes discretionary actions to increase its spending and/or to cut taxes. The government's borrowing to make up the difference between its additional outlays and reduced revenues cancels any increase in disposable income that allegedly would be produced by running a deficit.

Of course, the government might resort to the money printing press to finance the deficit. This might lead to an increase in nominal aggregate demand but only at the cost of pushing up the price level. Real disposable income and spending would increase only if people were fooled and failed to spot the inflationary erosion of their actual incomes and purchasing power.

Institute for Research on the Economics of Taxation

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1730 K Street, N.W., Suite 910, Washington, D.C. 20006
Voice 202-463-1400 • Fax 202-463-6199 • Internet www.iret.org

Public policy makers should not disregard Abe Lincoln's famous homily in making their policy decisions. They should, instead, rely on some homely, basic truths. Increases in the nation's income can't be produced by fiscal sleight of hand. Increases in real income depend on increases in real output. Increases in real output depend on increases in production inputs and/or in the efficiency of their use. Increases in production inputs depend on increases in the real rewards for supplying them.

Budget deficits will not maintain, let alone increase, real disposable income unless they result from fiscal actions that increase incentives for people to work, save, invest, innovate, start new businesses or expand existing enterprises.

History is no kinder to the Keynesian fiscalism than analysis. The record of the economy's aggregate performance reveals no evidence that budget deficits, *per se*, allay or moderate recessionary developments, or, indeed, that they exert any expansionary influence. Even the least demanding statistical tests of a relationship between federal budget outcomes and gross domestic product reject the notion that budget deficits are significant in moderating recessionary forces.

In this era of heightened concern about the federal government's preempting too much of the nation's production capability and misdirecting its use, opposition to curbing the growth in government spending and federal deficits by imposing a budget-balancing constitutional requirement is truly bizarre. Basing that opposition on the Keynesian fiscal mythology is even weirder. It is to be hoped that the U.S. Senate will base its decision about a Balanced Budget Amendment on consideration of the really relevant concern about how most effectively to discipline fiscal and budget policy decision making.

Norman B. Ture
President

Note: Nothing written here is to be construed as necessarily reflecting the views of IRET or as an attempt to aid or hinder the passage of any bill before Congress.