IRET Byline

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Clinton's Clutch: Laying Eggs on Economic Stimulus and Economic History

The day after the Easter egg hunt on the White House lawn, President Clinton laid two eggs of his own, one regarding economic history, the other, economic policy.

In fielding questions from reporters following his proclamation on Monday, April 12, of National Preschool Immunization Week, Mr. Clinton charged: "The Republicans had 12 years in which unemployment went down only when they were exploding the deficit and increasing the defense budget." Clinton then went on to promote his own proposal to increase federal taxes and spending on non-defense projects to create jobs. Clinton's cheap shot regarding jobs and deficit spending during the 1980s is not one for which lovers of truth in economics should turn the other cheek. The conclusion he draws, that government spending is good for job creation, is equally in error.

Neither the Reagan nor the Bush years offer support for Clinton's Keynesian-style contentions about unemployment, defense spending, and the deficit.

The eight years chiefly affected by Reagan's economic policies were 1981-1989. Unemployment rose early in the 1980s, a period when the real deficit and real defense outlays were rising sharply, and real domestic spending rose modestly. Employment rose and unemployment fell later in the 1980s, a time when the real deficit plateaued and then fell, real defense outlays rose further and then leveled off, and real non-defense outlays grew somewhat faster.

The Bush years, 1989-1992, were a time of falling real defense outlays; they were also a time of sharply rising non-defense and total outlays, rising deficits, recession, virtually no job growth, and elevated unemployment.

Directions of Change in Real Federal Deficit, Defense and Other Outlays, Unemployment: 1980-1992 by 3-year periods.

Period	1980-83	1983-86	1986-89	1989-92
Deficit	+	-	-	+
Defense Outlays	+	+	0	-
Other Outlays (ex-interest)	+	+	+	+
Total Outlays (ex-interest)	+	+	+	+
Unemployment rate	+	-	-	+

The data from 1980 through 1992 show that job growth and unemployment did not follow changes in the deficit and defense outlays as Clinton claims. Contrary to Clinton's charge, unemployment generally rose when deficits were rising, and generally fell when deficits were falling. (See chart and table.) It is more plausible to infer that causation runs from the economy to the deficit, not vice versa: that real economic growth and job gains lead to a lower deficit, not that a higher deficit leads to growth and jobs.

The facts regarding a link between government spending and jobs also do not support Clinton. The unemployment rate actually rose during the rapid initial stage of the defense build-up, fell as the build-up reached its peak, continued to fall after defense spending leveled off, and rose as defense spending

Federal Budget Deficits, Defense Spending, and Other Outlays in Real 1987 Dollars, 1980-1992													
	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992
Real Deficit	104.0	101.1	152.9	236.8	203.2	224.6	227.3	149.8	149.8	141.0	196.2	228.4	239.1
Real Defense Outlays	188.7	201.5	221.4	239.2	249.2	267.4	280.8	282.0	280.2	280.7	265.3	231.6	245.8
Real Non-defense Outlays (ex-interest)	569.4	578.2	568.1	579.6	562.5	596.8	596.7	583.3	600.3	619.9	681.6	725.5	728.3
Real Total Outlays (ex-interest)	758.1	779.7	789.5	818.8	811.8	864.2	877.5	865.3	880.5	900.7	946.9	957.1	974.1
Employment (millions)	100.9	102.0	101.2	102.5	106.7	108.9	111.3	114.2	116.7	119.0	119.6	118.4	119.2
Unemployment rate	7.0	7.5	9.5	9.5	7.4	7.1	6.9	6.1	5.4	5.2	5.4	6.6	7.3
Deficit and outlay figures (excluding interest) by fiscal year, employment and unemployment figures by calendar year. Deficit and outlay figures from *Budget Baselines, Historical Data, and Alternatives for the Future*, budget statement of the President, Jan., 1993; employment and unemployment figures from *Economic Report of the President*, 1993.													

fell. No close relationship is apparent. Perhaps it might make more sense to look at total federal outlays; defense has no monopoly on the public purse. But real non-defense spending and real total outlays rose in every sub-period as unemployment gyrated. (See chart and table.) The dip in defense spending during the 1990-1991 recession, when employment also dipped, coincidentally fits the Clinton scenario, but that dip in defense spending was swamped by the increase in other federal outlays. The sharp rise in other federal spending lifted total outlays and should have stimulated GDP in Clinton's Keynesian outlook, yet unemployment rose. Clearly, the strong relationship between higher government spending and lower unemployment that Mr. Clinton assumes does not exist.

Clinton's misperception of history matches his misperception of economics. The private sector, not government, creates economic growth. Neither higher government spending nor higher budget deficits per se stimulate the economy. Federal spending restraint is not contractionary.

Government spending does not create jobs and add to the GDP. The labor and capital services absorbed by government would have produced something else had government not commandeered them. Thus, federal highway construction may mean that more people work at building roads and fewer people work at building apartments; federal defense spending may mean that more people build fighter planes, warships, and rockets and fewer people build automobiles, appliances, and consumer electronics products; federal welfare programs may mean that there are more bureaucrats and social workers and fewer teachers, librarians, farmers, shopkeepers, or workers in any other occupation.

Federal spending increases economic output only when the particular federal spending project is a more valuable use of resources than the private sector use it displaced. Since federal spending projects, including infrastructure, are seldom subject to a market test of value, it is hard to show that the projects are a net gain to the society.

Deficit spending is no more stimulative than spending covered by tax hikes. Whether federal spending is paid for through borrowing (a.k.a. deficit spending) or taxing, it reduces private sector command over resources. Private consumption, saving and investment must be less than they would be without the government spending. The tax route may impose disincentives to work, save, and invest that borrowing does not. Borrowing may hide the cost of government and encourage more overspending than the tax route. Neither method of funding higher government spending is good for the economy when the increased spending is bad. Conversely, deficit reduction brought about by spending cuts is not contractionary. The real resources released will be used, more productively, elsewhere, after a short adjustment period.

Deficit reduction brought about by tax increases is another story. A very different argument, completely contrary to the Keynesian deficits-are-stimulative viewpoint, is sometimes made that higher taxes and lower deficits would enhance growth by reducing federal borrowing and thereby divert less private saving from private investment. This argument is flawed. In reality, the government would borrow less private saving if the deficit were lower, but the tax increase would reduce the amount of private saving by as much or more. The amount of saving left to finance private investment would not increase, and might well fall. And since spending would not be changed, there would be no real manpower or material resources released to expand private sector creation of capital goods. Thus, the notion that deficit reduction per se is good for growth is also a misperception. This notion, often used as a rationale for imposing higher taxes, was trotted out frequently during the Bush years, and has been used by Clinton advisers on occasions when Keynesian pump-priming was not being touted.

The fact is that deficits are the result, not the cause, of other budget decisions and of economic performance. When government spending is restrained, the private economy expands; jobs are created, not destroyed, and the deficit tends to fall. When government spending rises, private sector jobs are destroyed, not created, and deficits widen to no good effect. Tax rate increases may reduce the deficit, but only at the cost of reduced private sector activity. If the reduction in activity is great enough, the deficit may actually increase.

To date, the Clinton Administration's vision of economics might be described as the view from the Ovoid Office. To avoid laying an economic policy egg, the Clinton Administration needs to learn the real-world connection between the federal budget and the economy. It needs to devote itself to reducing the tax and regulatory burdens on private sector production, instead of increasing them. It needs to forget about designing an ivory tower industrial policy for the government and get out of the way of honest-to-goodness industrial expansion by the private sector. And for goodness sake, let us have no more cheap shots at the 1980s; they were a darn sight better than the 1990s have proven to be thus far.

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Note: Nothing 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 the Congress.