GOVERNMENT EXPENDITURE AND ECONOMIC GROWTH

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Fifty years ago the great economic oversimplification was that "supply created its own demand." Purchasing power would take care of itself. Today the equivalent error is that "demand creates its own supply." Spend more money and increased output and employment must follow. To untangle these problems will require careful thought.

There are really two questions raised by the outline for this hearing. The first concerns the direct efficiency of government outlay—in what lines does government activity do better, or contribute more to growth than the private economy. The second question concerns the effect of a given amount of government outlay (usually thought of as deficit financed) on economic activity generally. Naturally these two sets of problems overlap a good deal but we should try to keep them distinct in our minds as much as possible.

Concerning the first problem: Even if we decide that government enterprise is theoretically better in a given line than private, that still does not justify us in estimating the benefit of government action merely from the size of the appropriation. As in the case of private business, it could be greater than indicated, and it could be much less. In business the efficiency of a firm and the creativeness of its ideas may be just as, or much more important than, the size of its capital. So it is with governments. Benefits to growth cannot be deduced from the mere size of appropriation. Two factors must also be considered: (*a*) efficiency; (*b*) how much private activity in the same line may have been reduced.

Because there has just been a hearing on the question of objects of government activity (though I have not seen it while writing this statement) and because time is short, I will allot the rest of this statement to the problem of general economic activity. The committee may be interested, if more material on the general philosophy of public versus private outlay is needed, in reading my Democracy and Progress (Macmillan 1948) and A Key to Modern Economics (Macmillan 1955).

Turning now to the problem of government expenditure and general economic activity, I should like to submit emphatically that there is no mechanically foreseeable or 100 percent reliable relationship, in either direction, between government expenditure—however financed or directed—and general economic growth.

Take inflation. When one makes a prediction that increased government outlay in some line is going to cause inflation, this prediction must depend upon a battery of hidden (or, indeed, explicit) assumptions as to the behavior of the rest of the economy and the type of taxation or borrowing—none of which need prove true. For example, on a basis of things as is—that is, on the basis of present trends, assumed rates of change, and assumed fiscal policy, the analytical core for an inflationary prediction might, in a given year, be overwhelming. But if there is one thing which the statistical record establishes it is that things do not always stay as is. History is full of infinite surprises. Any honest economist must admit that there is an inevitable element of hunch in all economic prediction.

The committee should also remember that even if a given increase in appropriations is covered by taxes this does not mean that inflationary danger is avoided. First of all, the tax may fall on money that was hitherto idle and thus increase the quantity of money in effective circulation. But next, consumers or private businessmen may try to keep up their expenditure, and, by encroaching on reserves or borrowing, the volume of money spent may not drop even while government is spending and taxing more. Thus inflationary pressure will continue. So always one has to consider not just the size of the appropriation, but the type of taxation, and the response of the rest of the economy.

We turn now to the question of depression, and less than "full" employment—there, of course, mechanical prediction has run riot. But there is one basic error. The consumer does not have to spend his money. Even if he does the businessman does not have to put in orders for more goods, even supposing he allows the stocks on hand to be sold. Always any increase in buying, to be translated into more employment and production, must pass through the decisions made in the minds of the managers of production—largely businessmen in our economy, government officials in a Socialist one—the discrepancy, in this connection, between appropriation by Congress to various agencies, and amounts actually spent, shows that the government official, also, is not a purely automatic respender any more than the businessman.

Coming now to the question of the business decision, since that is still a most important element in our country, this decision is cast in terms of expected profit and loss. There exists a certain amount of highly inconclusive evidence to show that some businessmen work for "love." But the factual base is extremely shaky. Even if some men will do some work for little reward, will as many men do as much work as we want without incentive?

Now suppose, in depression, government spends more and in the first instance increases actual outlay. This still may not increase employment if, on the one hand, rapidly rising money wages, and on the other, increased taxation of profit leave the businessman and investor no adequate hope of reward. Increased government outlay may be neutralized by higher money wages. In this connection I should like to quote Dr. Kenneth Boulding's little jingle from The Impact of the Union, D. McC. Wright, editor, Kelley & Millman, 1957.

"We all or nearly all consent
If wages rise by 10 percent
It puts a choice before the Nation
Of unemployment or inflation."

The problem is that expansion is not a matter of moving smoothly upward. Even in a completely planned state one cannot expect all industries to grow at the same rate. Still less is this true of the unplanned society. The result is that from time to time the various spontaneous rates of change will not add up to full employment. In that case, if depression is spreading rapidly and seriously, a case is made out for deficit finance. But the trouble here is that the money injected does not just die. And once the momentum of change picks up we will find ourselves with too much purchasing power—and have to tax. But this is a very unpopular thing politically. Witness our post World War II experience.

For myself I feel that if one does not hamstring society with unwise remedies the impact of technical change will soon pull it out of depression. Thus we have to use the utmost caution before throwing in purchasing power or we may find that we have done so prematurely.

The above statement gives my general philosophy. I can't cover so huge a field in detail and will wait for questions. I annex a statement on Lord Keynes' views—not that I think Keynes is infallible but simply because his teaching is so often misunderstood and cited as authority for doctrines he would have undoubtedly repudiated.

Appendix on Keynes

Keynes is generally thought to have taught that if the government ran a deficit it would necessarily and immediately raise income.

But in the General Theory, pages 122–124, he distinguishes quite clearly between the logical theory of the multiplier and the consequences of an expansion in the capital goods industries. In other words, he knew the difference between a theoretical model and reality.

Keynes is often thought to have advocated higher money wage increases as a cure for depression. This is entirely mistaken. On pages 270–271 he explicitly favors keeping wages stable.

Even more important he sometimes argues, pages 264, 265, that money wage reduction would stimulate recovery.

Keynes was extremely concerned with the need for an optimistic business climate, page 162.

He even admitted, page 172, that—

> a large increase in the quantity of money may cause so much uncertainty about the future that liquidity preference [the desire to hold money rather than invest it] may be strengthened.

In other words, the deficit itself can sometimes scare the businessman out of activity.

Keynes thought a "scheme for the higher taxation of large incomes and inheritances" might lead to too low a rate of accumulation, investment, and economic growth, page 377.