

Matthew Lau: Stop force-feeding our already obese government

There are several good reasons why government spending sprees are no good for the economy

Dec 10, 2020

Matthew Lau

On top of the \$620 billion in net debt it plans to add over four years, the federal government has budgeted an additional \$70 billion to \$100 billion in “stimulus” spending. The details as to what the money is for have yet to be provided, but we are told that the spending will be feminist, intersectional, and climate-friendly. One thing the feminist climate stimulus does not appear to intersect with is good fiscal policy.

The Liberals would like us to believe that the expensive price tag, in the form of higher debt, is worth paying because of the economic growth the stimulus will deliver. Stimulus spending will surely increase the debt but is there any convincing evidence it will improve economic growth? The Liberals haven’t supplied any. Apparently, we are supposed to take it as gospel that government spending sprees are good for the economy. There are several good reasons why we should do no such thing.

To begin with, it is hard to argue as a matter of logic that the way to make spending and investment more productive is to have decisions about them made by people who did not earn the money, have no incentive to invest it wisely, and face no consequences if they spend it carelessly. The argument is even more difficult to make when we consider that those same people have declared the objective of their spending is not necessarily to allocate scarce resources to their most productive uses but rather to achieve collateral objectives related to feminism and climate change.

Proponents of stimulus spending would argue that it doesn’t actually take resources away from the private sector because it can be targeted to consume idle resources. Thus the government spending is on top of, not a replacement for, private sector activity. The problem with this sort of argument is that even if the government made an effort to consume only idle resources, which is not likely to be the case, it has no way of knowing which resources will be idle tomorrow, next month, or next year.

Plus, there is the moral hazard problem: by making idle resources the beneficiaries of its largesse, the government encourages more private-sector resources to become idle. If the government decides its stimulus will target unemployed workers, fewer unemployed workers will hurry back to work at the first job offer. Some may work less hard to keep their current jobs. Moreover, spending that is financed by borrowing creates uncertainty about future tax increases,

which discourages the private sector from committing to long-term investments. No matter how the stimulus is deployed, then, the certain result will be a reduction in private sector activity.

To be sure, government spending should not be zero, but expanding government into areas not affected by clear market failures is generally harmful. The appropriate level of government spending depends on what the spending is for and varies by circumstances. There is no precise estimate as to what it should be, but it seems clear that total government spending in Canada — which was 47 per cent of GDP in 2019, and which will be markedly higher over the next few years even before the planned stimulus — far surpasses anything that might be considered optimal.

A study by Livio Di Matteo in 2014 estimated that economic growth is maximized when the ratio of total government spending to GDP is 26 per cent, but even that may be too high. An earlier study by economist Georgios Karras put it at just 14 per cent for an average OECD country, and another of his studies put it at 16 per cent for an average country in Europe. Meanwhile, a Cato Institute paper reported in 2011 that while trying to determine an optimal ratio of government spending to GDP is not a particularly useful task, most studies put it at between 15 and 30 per cent.

The Liberals' claim, then, that their stimulus spending will improve economic growth, is not one we should take as a priori true. A comparable claim would be that a man of average height who weighs 450 lbs. should commit himself to eating more deep-fried foods and chocolate cake, and doing no exercise, in order to improve his health. Like the 450-lb. man, government in Canada is already dangerously obese. Feeding it more seems unwise.