



Ideas Changing the World

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The Negative Consequences of Government Expenditure

The U.S. national debt currently stands at 62 percent of gross domestic product (GDP) -- its highest level since WWII. Under plausible assumptions, this ratio will rise to at least 80 percent and possibly 185 percent of GDP by 2035 and continue increasing thereafter. As the debt ratio increases, the country's creditors will demand higher and higher interest rates to continue financing this debt. This means even larger deficits and ultimately a U.S. default, says Jeffrey Miron, senior lecturer and director of undergraduate studies in the department of economics at Harvard University and a senior fellow at the Cato Institute.

Both macroeconomic and microeconomic perspectives suggest that tax increases cannot address the debt problem because higher taxes mean slower economic growth, reducing the scope for increased tax revenue. If tax increases cannot restore fiscal balance, the United States must slow the path of expenditure, starting with reforming entitlement spending, to avoid fiscal Armageddon. Expenditure cuts can simultaneously improve fiscal balance while enhancing economic growth.

Large chunks of current expenditure are counterproductive and fail to accomplish reasonable policy goals. Determining the ideal level of government expenditure is difficult, but just a few decades ago the United States was a productive economy with far lower expenditure.

- In the 1960s, for example, federal government expenditure was below 20 percent of GDP, and state and local expenditure was below 12 percent.
- This contrasts with roughly 25 percent and 15 percent now.

The good news is that, from a fiscal perspective, the United States can have its cake and eat it too. By slashing expenditure, the country can simultaneously improve economic efficiency and get the debt under control.

Source: Jeffrey Miron, "The Negative Consequences of Government Expenditure," Mercatus Center, November 2010.

For text:

http://mercatus.org/sites/default/files/publication/Negative%20Consequences%20Government%20Expenditure.MoP_Miron_11.9.10.pdf

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http://www.ncpa.org/sub/dpd/index.php?Article_Category=25