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Boost Economic Growth by Slashing the Size of Government

June 12, 2011 by [Dan Mitchell](#)

It doesn't get much attention, but one of the most interesting economic experiments in American history occurred right after World War II. Despite warnings of Armageddon from Keynesian economists, government spending was slashed as the United States demobilized from the war.

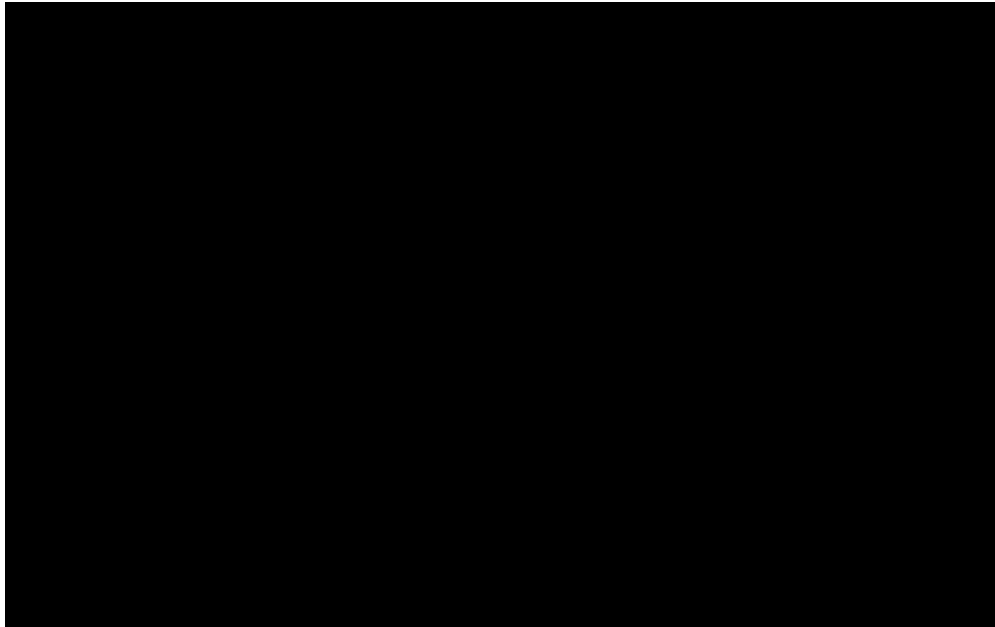
This was the opposite of the [failed Keynesian experiment of the 1930s](#), when massive increases in government spending [failed to boost economic growth](#).

So how did this experiment is smaller government work? Well, here's some of what [Jeff Jacoby wrote on the subject](#).

Writing last year in the Cato Policy Report, economists Jason Taylor and Richard Vedder showed that the great post-World War II economic boom was ushered in by the swift rollback of what had been the largest economic "stimulus" in US history. At the time, leading Keynesians cautioned that the abrupt withdrawal of federal dollars would plunge the economy into a new depression. Their warnings were ignored. "Government canceled war contracts, and its spending fell from \$84 billion in 1945 to under \$30 billion in 1946," Taylor and Vedder wrote. "By 1947, the government was . . . running a budget surplus of close to 6 percent of GDP. The military released around 10 million Americans back into civilian life. Most economic controls were lifted, and all were gone less than a year after V-J Day. In short, the economy underwent . . . the 'shock of de-stimulus.'" Fearful predictions of massive unemployment — 14 percent, Business Week said — never materialized. Far from collapsing, "labor markets adjusted quickly and efficiently once they were finally unfettered." Even with millions of demobilized soldiers re-entering the workforce, "unemployment rates . . . remained under 4.5 percent in the first three postwar years." Workers who lost government-funded jobs quickly replaced them in the surging private sector. "In fact," Taylor and Vedder add, "civilian employment grew, on net, by over 4 million between 1945 and 1947 when so many pundits were predicting economic

Armageddon. Household consumption, business investment, and net exports all boomed as government spending receded.” America’s postwar experience indicates that vibrant growth is generated not by massive government interference in the economy, but by the reverse. The way to revive a gasping private sector is for government to get out of its way, not to choke it with trillions of dollars in new spending.

Not surprisingly, Reagan understood this issue, as he said in [this video](#). Also, here’s one of my videos, which looks more broadly at the issue of whether government spending is a help or hindrance to economic growth.



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6 Responses

1. on [June 12, 2011 at 8:03 am](#) *The End is FAR*

Sorry Dan, it is not difficult to tell what the 'right' level of Government is. You don't attempt to figure out the 'appropriate' size of government by looking at GDP, growth, or shrinkage. That is a Macro Economic paradigm and is de facto Socialism. Hayek shows this quite well in 'The Fatal Conceit' and 'Road to Serfdom'.

Macro = Central Planning = Socialism = Central Coercion = Fascism = No Thanks!

You determine the size of it by the SCOPE of services that it delivers to ALL of the citizens that are 'voluntarily' paying for it. Forced payment may be exercised under extreme duress (i.e. invasion, asteroid impact) but that is the extreme exception, not the rule.

Look up the term Subsidiarity, <http://wp.me/pB8xR-a5>, that is how you determine the size of government and in a Micro Economic world there should be about 3,000 fully functional governments (counties) in the US that look after 80 – 90% of all gov't services. The Feds should be about 3-5% and the States the remainder.

2. on [June 12, 2011 at 1:48 pm](#) *Art R.*

The paragraph quoted above from Jeff Jacoby is disingenuous to say the least. The main reason why the economy boomed shortly after WWII ended was pent-up demand for consumer goods that were in short supply during the war. The US government had spent huge amounts of money on war production and since there was nothing much to buy, the defense workers saved their money in banks or bought war bonds. This was delayed Keynesianism. In addition, new technologies like television stimulated demand. Nationwide television was made possible by microwave transmission, which was a direct offshoot of microwave radar developed during the war. And the US was home to at least 12 television set manufacturers that I can recall: RCA, General Electric, Zenith, DuMont, Westinghouse, Sylvania, Emerson, Admiral, Philco, Motorola and Magnavox. Now there are none left.

U.S. industry also supplied the world with consumer goods and capital equipment, which might have once been supplied by European manufacturers destroyed in the war. The US was the world's export powerhouse at that time.

And don't forget the stimulative effects of the GI Bill that financed millions of new homes and paid college tuition for millions of vets.

3. on [June 12, 2011 at 3:06 pm](#) *Zorba*

Personally I seem to be some kind of economic oddity. See, I always seem to be possessed by unusual and insatiable demand. I exchange the goods and services I produce with the goods and services of other people, but still I'm left wanting for more and more... and more. I see stuff I'd like to buy all the time yet I don't produce enough to exchange my labor with more. Politicians don't help much either by not forcing enough other people to exchange what they create for what I can produce, but that's another story. Oddly enough, even if people were to give me more stuff as a gift, in exchange for nothing, I'd take it and then still want more, if you can believe that. Unlike most people apparently my problem is not lack of demand, but limited supply, i.e. the fact that I

do not seem to be producing enough to exchange my labor for all the goods and services that I want from the rest of the world. Why I always want more, I do not know, I'm some kind of oddity. I just never seem to be able to say "Now I have enough – the world has nothing more to offer me".

What a pity there are not that many people like me. The economy would flourish and we would all prosper if only there were more people who wanted more. Demand would loose the primary importance it seems to play in economic growth and demand would no longer be the main bottleneck to growth. Too bad so few people seem to want more things...

4. on [June 12, 2011 at 4:10 pm](#) *Robert Higgs*

People's ideas about the demobilization are almost always screwed up. I tried to sort out what really happened and why in an article published in the Journal of Economic History in September 1999, "From Central Planning to the Market: The American Transition, 1945-47," which (slightly revised) now forms chapter 5 of my book *Depression, War, and Cold War* (Oxford U.P., 2006). There is no way to put a "Keynesians were right" spin on this story and still be true to the facts. This episode was the definitive refutation of Keynesianism, but, strange to say, went unrecognized as such for decades. What's the excuse now? Don't peer-reviewed articles in the leading journal of economic history and books published by OUP carry any weight in this debate? Or are shots from the hip by anonymous blog commenters just as potent?

5. on [June 13, 2011 at 7:19 am](#) *Mark*

Dan keeps defending Reagan. Why? Reagan was a statist that cut the top tax rate.

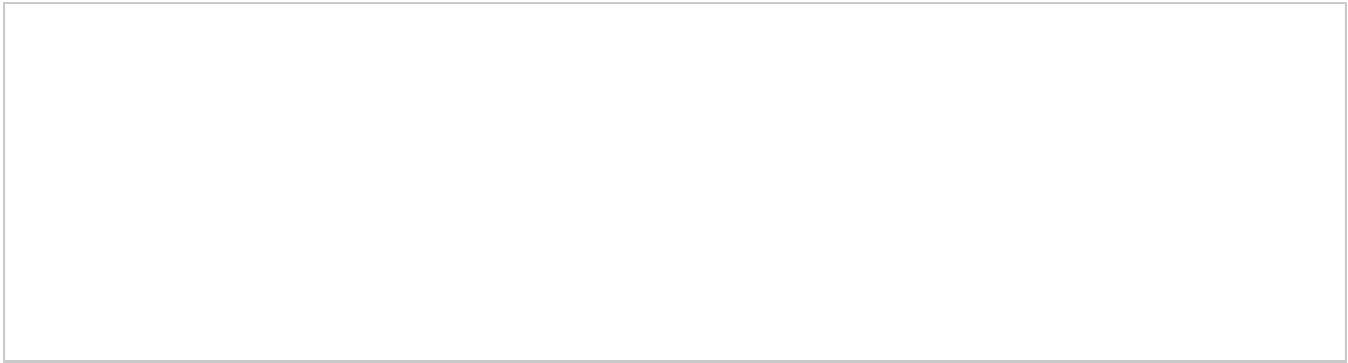
6. on [June 13, 2011 at 7:25 am](#) *Mark*

Art there is always "pent up demand" and new industries. We have lot of "pent up demand" and new industries (Apple, Dow Chemical solar shingles, electric cars) in 2011 and the economy is going right back in the toilet.

All Keynesian economist does is make excuses to spend government money and when the economy is good it is because of government money sent and when it is bad there is some excuse forthcoming and we need top spend more government money. The better sounding excuse a Keynesian can come up with to spend the higher the Keynesian is promoted.

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