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Hey Big Spender?

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Whether it is Greece or the US, it seems as though the headline *du jour* involves government deficits and debt. The Obama administration has taken a lot of heat for its projected US deficit and debt ratios. But are government deficits and debt really the big economic issues or is it government spending? Milton Friedman thought that the ultimate economic cost of government was *not how* the government funded itself, but *how much* funding the government was engaged in. Friedman understood that just as the Northwest Mountie always gets his man, the federal government *always* gets its funds. There are three ways the federal government can obtain funds and all three are economically “bad.” The three ways are taxation, debt issuance or “printing.” If taxation is used, households will cut back on their saving, which deprives the business sector of productivity-enhancing spending. If borrowing is employed, interest rates will rise, which will discourage businesses from engaging in productivity-enhancing spending. If “printing” is employed, the resulting inflation will also discourage households from saving, which will have similar consequences as taxation. In the end, if the federal government spends more, it takes control of more productive economic resources, depriving the private sector of the use of these resources. The deprivation of resources to the private sector has a negative effect on productivity growth, which, in turn, depresses long-run real economic growth.

Now, arguments have been made that some increased federal government spending conceivably could enhance private sector productivity. The interstate highway system is often mentioned as an example of this. If it could be demonstrated that the enhanced productivity from this type of government infrastructure spending was equal to or greater than the enhanced productivity that otherwise would have occurred if these resources had been left for the use of the private sector, then the increased government spending would not entail an economic cost. Arguments have been made that increased defense spending could enhance productivity. After all, if you cannot defend the wealth and income-generating resources of your economy against bad guys, then you are not going to be very productive when the bad guys confiscate your resources.

But a lot of government spending does *not* fall into either of these categories. Rather a lot of government spending is for “pork,” to maintain an army of bureaucrats (rather than soldiers and sailors) or transfers of income to non-producers in the economy, primarily retirees. And the projections of federal government spending increases over the next decades are dominated by the latter category – transfers of income to retirees. The ultimate cost of this government spending, regardless of how the funds are obtained, will be a reduced per-capita rate of economic growth. The reason for this reduced economic growth rate is that future workers will be deprived of productivity-enhancing resources as more resources are channeled to retirees. As mentioned above, productivity growth is a key determinant of long-run per-capita real economic growth.

This is the economic challenge that lays ahead – projected ever-increasing government spending on retirees. *How* this spending is *funded* is a *secondary* issue. The *increased spending* is the primary issue.

I began this commentary by saying that the Obama administration has come under a lot of criticism for the deficits and debt projected to occur in the coming years as a result of its fiscal policies. But let us be objective and look at the recent history and projections of federal government spending – spending projections made by the Obama administration as well as by the non-partisan Congressional Budget Office (CBO). These data are contained in Table 1 below. Table 2 contains the economic forecasts assumed by the CBO, the Obama administration and the Blue Chip panel of forecasters (median). The Blue Chip forecast survey does not go beyond 2011.

Table 1

Growth of Federal Government Outlays (% , fiscal years)

Budget Category	1993 - 2001	2001 - 2009	2009 - 2017 (CBO)	2009 -2017 (Obama)
Defense Discretionary	0.6	10	1.9	1.6
Nondefense Discretionary	4.2	6.8	1.7	1.3
Mandatory	5.2	9.6	2.4	3.7
Net Interest	0.5	-1.2	15.0	17.5
Total ex Defense	4.2	7.9	3.5	4.8
Total ex Interest	4.0	9.1	2.1	2.9
Total ex Defense & Interest	4.9	8.9	2.2	3.3
Total	3.5	8.3	3.2	4.1

Note: Growth rates for the eight years ended 2001 and 2009 are actual; growth rates for the eight years ended 2017 are baseline projections made by the CBO and projections made by the Obama administration of its proposed budget in January 2010.

Table 2

Economic Projections – CBO, Obama Administration, and Blue Chip Survey

Economic Variable	2010 - 2011 (CBO)	2010 - 2011 (Obama)	2010 - 2011 (Blue Chip)	2012 - 2014 (CBO)	2012 - 2014 (Obama)	2015 - 2020 (CBO)	2015 - 2020 (Obama)
Real GDP (compound annual growth rate %)	2.05	3.25	3.05	4.40	4.17	2.40	2.87
Nominal GDP (compound annual growth rate %)	3.00	4.35	4.45	5.60	5.93	4.20	4.70
3-Mo. T-Bill Rate (average %)	0.45	1.00	1.10	2.90	3.70	4.60	4.10
10-Yr. Treasury Note Rate (average %)	3.75	4.20	4.35	4.50	5.17	5.50	5.30

The time spans for budget projections (Table 1) are broken into eight-year periods, roughly equal to those years under which Presidents Clinton and Bush #43 had control over budgets. The spending growth rates for the eight years ended 2017 projected by the CBO are based on its economic forecasts and on current law. These CBO spending forecasts do *not* reflect President Obama’s *future* fiscal policy proposals, only the policies already enacted by the Obama administration and those policies still in effect from prior administrations. The last column contains projections in the January 2010 Obama administration proposed budget, which incorporate the administration’s economic forecast over the relevant period.

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Before discussing the federal government spending data in Table 1, let me say a few words about the economic assumptions in Table 2. For 2010 and 2011, the Obama administration economic forecast is at significant variance with that of the CBO. The Obama administration expects stronger real and nominal GDP growth than does the CBO. Although it is not surprising that a presidential administration might err on the side of optimism when it comes to economic growth, notice that the Blue Chip median forecasts for 2010 and 2011 are *not* that much less optimistic than the Obama administration's economic forecast. The outlier here is not the Obama administration but the CBO. Notice also that in the three years ended 2014, the CBO's real GDP growth forecast is actually a little higher than the Obama administration's. Basically in the "out years," the differences in real and nominal GDP growth forecasts are not significantly different, especially when you take into consideration that these forecasts border on pure guesses. In sum, the criticism that the Obama administration is looking through rose-colored glasses with regard to its economic forecast, which would have an effect on its budget projections, does not hold up to scrutiny. The Obama administration's forecast is not significantly more optimistic about the near-term economic outlook than is the Blue Chip panel of forecasters and not significantly more optimistic about the economic outlook in the out years than the non-partisan CBO.

Now, to determine who the big spender is, or more accurately, *was*. Table 1 says it was President Bush #43. In only one category, net interest payments on the federal debt, was the compound annual rate of growth less than it was in the Clinton administration or *projected* to be over the next eight years by the CBO and the Obama administration. Over the next eight years compared with the previous eight years, the CBO and the Obama administration project a significant slowdown in the rate of growth in all major categories of federal spending *except* for *net interest*. The reason net interest outlays are projected to increase so rapidly over the *next* eight years is because of the significant acceleration in federal spending in the *previous* eight years that was funded by increased debt. Compound interest is catching up with us.

Make no mistake about it. There is a serious fiscal challenge ahead. But the heated rhetoric about deficits and debt is just a smokescreen. The key underlying economic issue is spending. And the biggest government spending challenge is related to the diversion of productive resources to *future* retirees, which will build over the next 20 years as more and more baby boomers retire. The second biggest government spending challenge is related to the mushrooming interest payments on the prior debt issued. The responsibility for this serious fiscal challenge ahead can be traced back to *prior* federal government policies that instituted retiree entitlement programs and funded rapidly rising federal government spending with the issuance of debt.

Paul Kasriel is the recipient of the 2006 Lawrence R. Klein Award for Blue Chip Forecasting Accuracy