



## LECTURE EIGHT - PART SIX



### **The Doves: Productivity Rises**

- Private sector productivity benefits from public investment in roads, bridges, education, etc.
- Such investment increases the productivity of the private sector and thereby boosts both economic growth and real national income.

## The Hawks: Productivity Falls

- Far too many government expenditures are made on “wasting assets” rather than productive capital.
- Roads, bridges, and education may boost productivity.
- However, **wasting assets** such as fighter planes and welfare programs **don't** boost productivity.

## The Hawks: Long Term Growth Falls

- Studies show public sector investment is less productive.
- When deficits crowd out private sector investment, long term growth falls.
- **Why?** Deficit spending substitutes less productive government expenditures for more productive private investment!!!

## The Hawks: Deficits Constrain Fiscal Policy When It Is Most Needed

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- **Historical Example:** The Fed cut interest rates to stimulate the sluggish economy but fiscal policy wasn't used because of the big budget deficit.
- Expansionary monetary policy alone was slow to expand output and reduce unemployment.

## Hindsight Is A Soaring Budget Deficit

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- In the absence of a soaring budget deficit, it would have been politically easier to use fiscal policy by reducing taxes or increasing spending.
- The growing debt problem helped rule this stimulus out on political grounds.



## **The Deficit Hawks Summary**

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- Chronic budget deficits increase the trade deficit, crowd out private investment, and reduce economic growth.
- A growing public debt unfairly burdens future generations and exposes America to dangerous political pressures from foreign governments.
- Servicing the debt redistributes income from the poor to the rich.

## **The Deficit Doves Summary**

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- The deficit is a stimulus to economic growth, and Doves reject both the crowding out and trade deficit arguments.
- The national debt represents productive investment in public goods and infrastructure.
- The debt is manageable relative to GDP.
- Since we “owe it largely to ourselves,” it is not a problem.

## **A Balanced Budget Amendment**

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- Would compel Congress to annually balance its budget.

### **Question**

What impact do you think a Balanced Budget Amendment would have on the use of discretionary fiscal policy?

## **The Perverse Effect of A Balanced Budget Amendment**

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- The Amendment would force the government to balance the budget during a recession by increasing taxes and/or cut spending.
- From a Keynesian perspective, this contractionary fiscal policy perversely would plunge the economy deeper into recession!



## THE POWER OF MACROECONOMICS

Professor Peter Navarro  
University of California-Irvine

### END OF LESSON EIGHT



## Coming Up Next!

Lesson Nine:  
International Trade and Protectionism