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## **Spending Our Way to Wealth and Prosperity**

**by Jacob G. Hornberger**

One of the most ludicrous policy prescriptions issued by federal officials is the one that exhorts the citizenry to spend more money to get the nation out of a recession. That's the key to national economic prosperity, government officials exclaim. "Go to the mall and shop," they tell people. If people will just spend, spend, and spend some more, the nation will get back on the road to a healthy economy, or so the argument goes.

The government does its part in the spending department as well. Economic stimulus packages and public-works campaigns; Social Security, Medicare, and other welfare programs; and Iraq, Afghanistan, and the other ever-increasing expenditures on the military and the military-industrial complex. It all adds up to massive federal spending, which is sold as a way to get the nation out of recessions and depressions.

It is phenomenal that Americans fell for this nonsense back in the 1930s and even more so that they continue to fall for it. It's really a testament to the power of government control and influence over the education of the American people, from the first grade all the way through college. What else could explain how people fall for such an inane notion as "consumption is the key to national wealth and prosperity"?

Let's focus on a hypothetical family. The husband earns \$70,000 a year. The wife works at home taking care of the children. At the end of the year, after having paid all expenses and taxes, the family has \$10,000 left over. What should this family do with the money?

According to federal officials, the economy would be better off if they spend the \$10,000 on a vacation, meals at restaurants, or a new automobile. In other words, the family should spend the money on consumption goods rather than save it. Consumption produces jobs for other people, they tell us. That gets the economy humming and ultimately booming.

If \$10,000 isn't sufficient to buy all those things, no problem. Government officials exhort the family to borrow, with a bank loan, with their home as collateral, or simply by running up a tab on credit cards. All that increased spending will benefit the nation, they tell us. People should feel good, perhaps even patriotic, about all that spending.

In the eyes of government officials, the worst thing the family could do is save the money. According to them, savings produces unemployment because if people aren't buying vacations, eating out, or buying automobiles, then people will be laid off in those sectors. Thus, when families save money, the notion goes, they harm the economy and the nation.

But look at it in terms of our hypothetical family. Let's assume that every year they go ahead and help the economy by spending the \$10,000 that's left over. To be better citizens, they also run up \$5,000 a year in bank loans and credit-card debt. At the end of 10 years, they have no savings and they're \$50,000 in debt. They can't afford a vacation, restaurant meals, or another new car. The family cannot even pay their children's college bills.

Now, compare another hypothetical family. Year after year, Family 2 has placed its \$10,000 in a savings account. At the end of ten years, it has succeeded in saving \$120,000, including interest.

Now obviously, we cannot necessarily say that Family 2 is better off than Family 1 because value is subjective. Family 1 might have placed a higher value on short-term consumption than on savings while Family 2 placed a higher value on savings than it did on consumption.

But what we can do is show overall how people in a society are actually better off the more they are saving rather than consuming.

Let's assume that Family 2 keep their money in a bank savings account. The money doesn't just sit there. The bank lends it out, say, to a firm investing in more productive equipment. The reason the firm does that is that it knows that by making its workers more productive, it stands to earn higher revenues even after repaying the loan plus interest.

Thus, when people save, that money is actually being spent, but for capital goods rather than consumption goods. The spending is indirect and, thus, difficult to see. It's not as open and flashy as going to the mall and buying something, but it is nonetheless being used to indirectly make a purchase — of a tractor, a computer, or a piece of machinery.

Who benefits from that capital spending? Nearly everyone in society does. The owner benefits because of increased revenues and profits. Workers benefit because there is now more revenue by which to give raises to his employees. Consumers benefit by the increased supply of goods on the market. The saver benefits because he's earning interest on his money.

Thus, Family 2's failure to consume their leftover money at the mall doesn't cause unemployment; it simply reorients employment. Employment gravitates from consumption-oriented sectors to capital-producing sectors.

## **Capital and productivity**

One of the most important factors to consider in all this is that savings and capital are key to raising the standard of living in a society. Increased levels of capital make workers more productive. More productivity leads to higher revenues and higher wages.

Consider a very simple example. Farmer Jones is producing \$100,000 in revenues. His expenses and taxes, including payroll, amount to \$70,000, earning him a net profit of \$30,000, which he uses to buy a tractor rather than a new car. His workers, who previously had used hoes, are able to increase production, which raises revenues to \$125,000, which provides additional money to raise the wages of the workers.

Thus, it's not surprising that throughout the 1900s, the standard of living of the American people was soaring, despite the fact that thousands of penniless immigrants, many of whom couldn't even speak English, were flooding American shores. In other words, population was going up and so were real wage rates! For the first time in history, people were free to engage in economic activity without government control or restriction. They were also free to accumulate unlimited amounts of wealth and decide for themselves what to do with it. Obviously, there was considerable consumption but there was also massive savings, not only among the rich but also among the middle class and poor. That savings went into productive capital, which then caused the overall standard of living in American society to skyrocket.

Alas, it was not to last. Once Americans brought into existence this massive wealth-producing system, it became a tempting target to those people in society who would rather spend their time seizing and redistributing the rightfully earned money of other people. That's what the New Deal and Great Society were all about. That's what the welfare state is all about. That's what the big bailouts are all about. That's what the massive public-works projects are all about.

Government officials also tell Americans that increased government spending is a panacea to what ails the American economy. Of course, nobody dares to ask the obvious questions: If government spending is so beneficial, then why is America's economy doing so poorly, given that President Bush went on one of the biggest spending sprees in U.S. history during his two terms in office? Where is all the economic prosperity that that massive spending spree brought about?

And here are two more impertinent questions: If Ronald Reagan really did bring down the Soviet Union by making it spend the nation into bankruptcy, as conservatives often claim, how come all that spending brought bankruptcy, rather than prosperity, to the Soviet Union? Why wouldn't the same principle hold true for other countries, including the United States?

## **Paying for government**

We need to keep in mind that there are only three ways that government gets the money it uses to spend.

One, it taxes people. Taxing people means taking money out of their pockets and transferring it to government. When government spends such money on, say, a new highway, it can proudly point to the highway and say, “Look! Jobs created for your nation by your government.” But isn’t that silly when we consider that the money was taken out of people’s pockets? What about all the jobs that were destroyed because people were prevented from spending their money the way they wanted to?

Two, it borrows money. Let’s say that government officials build their new highway with funds that they’ve borrowed from the people. Isn’t that simply a reorientation of money that would have been used for productive capital (from private savings) to the building of some government project? How does that make people better off? Of course, again, government officials can point to the highway and exclaim, “Look at what we’ve done for you!” How many people will reflect on the impact that the redirection of capital has had on their overall standard of living?

Three, it can simply print the money it spends on constructing the new highway. This route enables public officials to exclaim that the new highway has been constructed for free — no new taxes and no new indebtedness. Hardly anyone is the wiser. When prices begin rising in response to the debased dollar, people will just mimic the accusations of their government officials and blame speculators, entrepreneurs, capitalists, greed, and price-gougers.

In his great book *Economics in One Lesson*, Henry Hazlitt succinctly summed up the issue of spending versus saving:

From time immemorial proverbial wisdom has taught the virtues of saving, and warned against the consequences of prodigality and waste. This proverbial wisdom has reflected the common ethical as well as the merely prudential judgments of mankind. But there have always been squanderers, and there have apparently always been theorists to rationalize their squandering.

The classical economists, refuting the fallacies of their own day, showed that the saving policy that was in the best interests of the individual was also in the best interests of the nation. They showed that the rational saver, in making provision for his future, was not hurting, but helping, the whole community. But today the ancient virtue of thrift, as well as its defense by the classical economists, is once more under attack, for allegedly new reasons, while the opposite doctrine of spending is in fashion.

If that is not clear enough, we may join Hazlitt in citing a maxim from Adam Smith:

“What is prudence in the conduct of every private family,” said Adam Smith’s strong common sense in reply to the sophists of his time, “can scarce be folly in that of a great kingdom.”

Contrary to exhortations from federal officials, the key to increases in wealth and to higher standards of living lies in savings, not spending. Americans would be wise to reject the spending/consumption paradigm and embrace the savings/capital paradigm.

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