Volume 5, Number 6 February 1998

Link Political Salaries to Average Income of Citizens

by Amy K. Frantz

"While there has been a growing consensus among a large proportion of the American population that government has grown too large, there is less agreement as to how to retard that growth." Dr. Richard Vedder and Dr. Lowell Gallaway of Ohio University argue that the best means of constraining government is to limit government expenditures in their chapter "Constitutional Spending Limitations and the Optimal Size of Government," from *Limiting Leviathan*.

Government spending crowds out private sector activities in many different ways. Higher government spending may raise interest rates, making private businesses and consumers less likely to borrow to finance expenditures. Consumers may increase their savings, thus decreasing their consumption, to protect their long-term financial well being. Deficit financing may ultimately increase the rate of inflation. "In short, more government spending generally means a reduction in the private sector's command over resources."

Vedder and Gallaway contrast behavior in the private sector with the public. In the private sector, firms that lower the costs of production will have higher profits. However, the government does not have to worry about competition, and has little incentive to cut costs. "Bigger government means lower productivity, and with that less economic growth and lower incomes."

The government has consumed an increasingly larger portion of America's output over the last century. In 1902, governmental expenditures totaled 7.69 percent of total output (gross national product or gross domestic product). By 1993, government was spending almost 40 percent of total output. This growth is not just a federal phenomenon. "[I]n the last several decades state and local spending has grown faster as a percent of total output than that of the federal government."

While government spending at such a high rate is crowding out private spending, most would agree that some government spending is necessary. But how much government spending is optimal, and at what point does government spending begin to have a negative impact? U.S. Representative Dick Armey, an economics professor prior to his election to Congress, has suggested that "increases in government spending from a zero level lead first to some increase in total output, but at some point the crowding out effects of increased government on balance become output-retarding, so further governmental spending growth reduces output."

Vedder and Gallaway have been looking at federal, state, and local government spending trends in the United States and in other countries to test the validity of the Armey curve. Their findings suggests that the Armey curve does, indeed, exist, and that spending levels in the United States have reached the portion of the Armey curve in which increases in government spending have negative effects on economic growth and output. "Thus the economic case for constitutionally constraining the size of government is strong."

Vedder and Gallaway believe a spending limitation is the preferred method to constrain the size of government. “A balanced budget amendment does not necessarily restrain spending much, as the experience of the states demonstrate.” Restrictions on taxes do not limit non-tax financing of government spending (such as fees), which made up 29 percent of the general revenue received by state and local governments in 1994.

However, no type of governmental limit is perfect. The authors discuss the numerous issues that must be resolved in formulating a spending limitation, such as what exactly constitutes an expenditure, and the likelihood of a court challenge to even the most carefully crafted spending limitation. Even with a constitutional limit on spending, governments can merely substitute unfunded mandates for increased government spending. Unfunded mandates could be prohibited by the language of the constitutional limit, but adding the language raises practical difficulties and adds to the threat of a legal challenge.

Vedder and Gallaway suggest an alternative approach to a spending limitation — indirectly limiting government spending by providing financial incentives to political decision makers. These incentives could include linking the compensation of government leaders to the average income of the citizens (for example, the annual salary of the President may be 20 times the personal income per capita of the population of the United States). This plan provides an incentive to adopt spending policies that maximize the income of the people.

Other alternatives are giving politicians “performance bonuses” of varying size depending on economic growth rates, or providing financial incentives for downsizing the government. Under the latter alternative, a constitutional amendment could be passed that provides for a 10 percent increase in salary for each one percent that expenditures fall below a chosen level of personal income, and a 10 percent decrease in salary for each one percent that expenditures rise above the chosen level of personal income.

While there are trade-offs between the effectiveness of these incentives and the simplicity of the constitutional language, Vedder and Gallaway’s plan does attempt to make the government more like the private sector, in which the economic well-being of those running the business is tied to the economic performance of the business. Under these alternative approaches to limiting government spending, “[t]he better off the citizens are, the better off the politicians will be.”

This Institute Brief is one in a series on the chapters of an upcoming book, Limiting Leviathan*, edited by Dr. Don Racheter, Executive Director of Public Interest Institute, and Dr. Richard Wagner, Economics Professor at George Mason University and Chairman of PII’s Academic Advisory Board.* Limiting Leviathan *makes a case for limited government and discusses the types of limitations on government that are appropriate and necessary.*

The authors of this chapter in Limiting Leviathan *are Dr. Richard Vedder and Dr. Lowell Gallaway of Ohio University.*

This summary of Drs. Vedder and Gallaway's chapter was written by Amy K. Frantz, a Research Analyst with Public Interest Institute.

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