A Complete Look at Federal Spending

The economic impact of the federal government in our society is undeniable; the federal budget for the 2007 fiscal year is a staggering $2.8 trillion, and that's not even considering the impact of regulation. As I've previously written, states which receive a larger share of the federal government pie experience worse economic performance. As if West Virginia by itself is not proof enough, this country-wide view reaffirms what economists have known for decades: More government makes economies poorer. It doesn't matter whether it is less federal pork or a freer economic climate at the state level—those states that have removed themselves most from the ever-expanding arm of the public sector now have stronger economies to show for it.

It is at this juncture that the most common rebuttal to the above reality emerges, and it usually goes something like the following. The government, in fact, has done a lot of good things, continues to do good things, and therefore federal spending has been good and should continue in the future. This line of reasoning highlights a common, yet crucial, error with regards to basic economic theory, and is worth exploring further.

Economics, among other things, deals with the allocation of scarce resources throughout society. If resources were not scarce, i.e. everyone could have as much of everything as they pleased, then how to allocate them would not be of any concern. Further, economics is concerned with processes that *best* allocate resources throughout a society. This is a crucial point that is often overlooked—economics is concerned with "best," not "good."

As such, declaring any allocation of products and services as "good" is worthless; after all, just about any outcome could be declared "good" in the eyes of someone. No one would be in favor of a $10 fee that, once collected, went directly into my bank account. But to me, this program would be as "good" as any state or federal program—and, given that federal projects require funds taken from the American population at large and benefit specifically designated groups, is fundamentally no different than the above Matt E. Ryan Tax that I'd find particularly appetizing.

For the sake of argument, however, I will cede the point that we can somehow objectively classify federal projects as "good," whatever that term may mean. Often cited examples of "good" projects are federally provided highways, or the gains from federally funded research and development. When argued as "good" spending, proponents cite the benefits from such outlays while ignoring the costs—akin to my proclaiming the Matt E. Ryan Tax as a $3 billion benefit while ignoring the $10 paid by each resident of this country. Additionally, not only do federal projects have an accounting cost which is a direct burden on the tax-paying public, but also what is known as an opportunity cost. Opportunity costs are the foregone alternatives that occur when we make decisions; for example, the opportunity cost of attending your favorite band's concert is the value of spending an evening with your family. When analyzing federal projects, the dollar cost as well as the foregone opportunities for those funds must be considered.

It is through this lens that federal programs must be viewed. When proponents of federal spending note the technological advances made by NASA, one must consider the multi-billion dollar cost as well as how that money, if left in the private sector, could otherwise have been used. In order to create economic value, the federal government must incorporate these funds in a manner that improves what the market would have done with them. Unfortunately, there are a host of reasons to believe that this will not be the case.

Within the structure of the market, producers and consumers act upon their localized knowledge and individual preferences to generate a system of allocation through an ever changing array of prices. Instead of a brewer in Belgium knowing the instantaneous preferences of every beer drinker in the world, they simply look at prices—for inputs into their production process and for their end product, beer—and make a profit maximizing decision about how, and for whom, to produce. It is through a freely functioning pricing system that the inconceivably large web of information needed to make appropriate allocation decisions is reduced to a single number.

The government has no such number. Decisions on where to pave federal highways, or which research programs to pursue, are not made in an environment of freely moving prices that reflect information and preferences because there is no direct link between supplier (government) and consumer (citizens). Instead, governments forcefully take funds from the public and supply goods and services where they, at best, feel they may do the most "good" or, at worst, where it most helps the legislator doing the allocating. In light of the shortcomings of having the government distribute resources, we instead have every reason to believe that *any* bit of federal spending is causing a net harm to the economy—it's just difficult to see because the more valuable alternative never had the chance to materialize.

As always, the answer is not more government. Be wary of any policy or advice that proclaims the virtues of Federal Program X—there's a costly underbelly when you dig just a little bit deeper.

Matt E. Ryan is the Charles G. Koch Doctoral Fellow at West Virginia University and an associate fellow for the Public Policy Foundation of West Virginia. He is an editor of "Unleashing Capitalism: Why Prosperity Stops at the West Virginia Border and How to Fix It." He can be reached at matt.ryan@mail.wvu.edu.