

# **A Policy Proposal for Employment and Prosperity**

**Keith Eubanks**  
**Dynamic Forecasting**  
<http://www.dynamicforecasting.com/>

**March 2011**

## **Abstract**

Future employment and prosperity are driven by society's investment to expand future production. How much current income society allocates toward investment determines how rapidly capital accumulates and how rapidly the productivity of that new capital improves. The accumulation of capital along with the steady improvement in its productivity enables society to grow the production that defines economic growth, and it is the relative rapidity of capital accumulation with respect to population growth that dictates how many people can be employed in the production process.

The United States may choose a prosperous path, with a growing economy and rising employment, but this will require expanding investment – specifically, private investment. It is private capital that drives the production process in the United States. It will be difficult, if not impossible, to increase private investment without curtailing government spending: reducing the share of national income spent by government.

This proposal first discusses the mechanisms through which private investment drives economic growth and employment. It then presents a path for gradually reducing government spending and increasing incentives for savings and investment. Estimates for policy outcomes are presented using simulated output from an economic growth model. In closing, this proposal recommends presenting the case for economic growth and the basic mechanisms that drive growth, not to the halls of Congress, but directly to the American people. It is after all the people's economy, the people's income and the people's future.

# Table of Contents

1.	Foundations .....	1
1.1	Private Investment Correlations and Causality .....	3
1.2	Recessions .....	6
1.3	Government vs. Private Investment .....	7
1.4	Monetary Inflation.....	7
1.5	Stability .....	8
2.	Proposal.....	9
2.1	Near-Term Policy Recommendations .....	9
2.1.1	Government Spending .....	9
2.1.2	Taxes .....	9
2.1.3	Social Security .....	10
2.1.4	Healthcare .....	10
2.1.5	Money .....	11
2.2	Long-Term Structural Reforms .....	12
3.	Simulated Policy Outcomes .....	14
4.	Conclusions.....	21

# 1. Foundations

“All production is for the purpose of ultimately satisfying the consumer.” British economist John Maynard Keynes said this in the 1930s<sup>1</sup>, and he was right. All the things we produce are ultimately for the purpose of consumption. In fact, all life both consumes to live and lives to consume.

The production of the goods and services we consume requires the application of capital and labor. Capital is the physical and intellectual means of production: our tools, land, buildings, knowledge and knowhow. Labor is the physical and intellectual efforts that we, humans, provide.

Although all production is for ultimately satisfying the consumer, it is not all for the immediate satisfaction of the consumer. Some of our capital and labor must be applied toward creating the means of production, i.e., toward creating future capital for future production. Capital wears out over time and must be replaced for production and consumption to continue. Furthermore, an expanding population requires additional capital to produce for its growing membership. And if we wish to increase our standard of living, new capital must be more productive than that which it replaces. This enables us to gradually produce more with our individual labors, and our standard of living is defined by the quality and quantity of what we produce and consume.

Real economic growth is defined by production; specifically, how quickly the quality and quantity of production grows (goods and services). This growth is controlled by how rapidly we accumulate additional capital and how rapidly the productivity of that capital improves. Capital accumulation and productivity improvement are driven by how we allocate our current capital and labor – toward producing capital or consumables. The more of our capital and labor we apply toward creating future capital the faster the economy can grow. The more of our capital and labor we apply toward creating consumables the slower the economy grows.

Income is generated by the successful exchange of goods and services produced. Money provides a means of indirect exchange, and money income is generated when the exchange of production is for money instead of others goods or services. There is a time constraint associated with the production, exchange and income process. Today’s income is limited by how much has previously been produced and is available for exchange and by what can be produced and exchanged today with existing capital.

It is the allocation of each day’s income that determines present and future living standards, and there is an explicit trade between the present and future in this allocation. As observed, growing the production that generates income requires allocating income

---

<sup>1</sup> Keynes, John Maynard “The General Theory of Employment, Interest, and Money”, Prometheus Books, New York, 1997, p. 46

toward capital creation. Current consumption must be curtailed to grow future income and consumption.

How much money income can be generated via the exchange of production and how much can be purchased with that money income (consumables or capital) is determined by prices. Prices set the relative valuation of goods and services produced.

Price is the great communicator. Prices tell us how people value the various goods and services produced and provide a means for suppliers and consumers to communicate that valuation. Price per se does not motivate suppliers to alter production. Profits do. Price tells suppliers whether they can profit by bringing products to the market or not. Only those who can profit will supply the market place. Price per se does not set demand. The subjective desires of the consumer balanced with the limits of their income and prices determine how much the consumer will purchase. In a free market, price is a very dynamic quantity as ever changing information concerning supply and demand push prices up and down.

As stated, prices determine the relative valuation of goods and services, but the absolute magnitude of prices is a function of the value of money itself. There is a supply and demand for money that is connected with the quantity of money in the market place and the quality and quantity of goods and services produced. When the value of money itself changes, all prices are forced to adjust. If the value of money increases, all prices are forced downward: deflation. If the value of money decreases, all prices are forced upward: inflation. Inflation and deflation affect the exchange of goods and services produced because not all prices change with the same speed – some prices change faster (commodities), some slower (wages). Inflation and deflation temporarily distort the relative valuation of goods and services and can lead to money-induced changes in how income is allocated.

Debt is a means to shift saved income from one person or organization to another. Often an individual or organization will have savings but no good prospects for investing that savings themselves. These people often loan their savings to someone who has a use for that income. Such loans may be direct from saver to spender or through an intermediary such as a bank, money market fund or other financial institution. The supply of real income available for loans in society is limited by the amount of income saved.

Whether debt is beneficial to economic growth or not depends upon what the borrowed income is spent on. As observed earlier, economic growth is driven by investment. If debt is undertaken to purchase capital that can be used to create goods and services that people want to buy, that debt promotes economic growth. If debt is used to finance consumption, it cannot drive economic growth; it is as if the original income were never saved at all.

## 1.1 Private Investment Correlations and Causality

Figure 1 presents a plot of Private Investment as a percent of U.S. national income with the Unemployment Rate in percentage terms<sup>2</sup>. The shape of the two lines would suggest a correlation between private investment and unemployment. This is not just a correlation. Private investment is a causal driver of employment. Private investment creates the capital that enables production, employment and real income to expand.

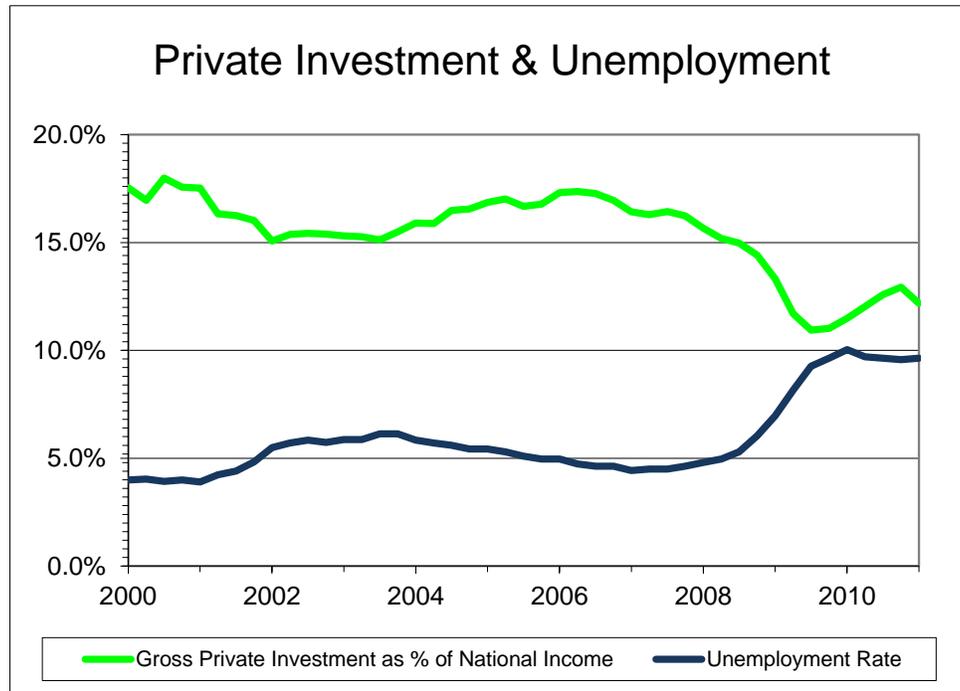


Figure 1: Private Investment and U.S. Unemployment Rate<sup>3</sup>

A common representation of the allocation of income is:

Income = Private Consumption + Private Investment + Government Consumption + Government Investment

Income equals spending, but income generation, and hence spending, is constrained by the successful exchange of goods and services produced. Hence in the short term, spending is a zero sum game. Any increase in consumption spending comes at the expense of investment spending. Any increase in government spending comes at the expense of private sector spending. In the long run, income can grow, or shrink, as more,

<sup>2</sup> Taylor, John B., *Wall Street Journal*, "A Two-Track Plan to Restore Growth", January 28, 2011 -- presented a similar chart.

<sup>3</sup> Bureau of Economic Analysis, NIPA Table 5.1 Line 23 for Gross Private Domestic Investment and Table 1.7.5 Line 28 for Gross National Income. Bureau of Labor Statistics, Seasonally Adjusted, Unemployment Rate for 16 Years and Older, Series I.D.: LNS14000000.

or fewer, goods are produced and exchanged. However, growing future income requires allocating current income toward investment so as to expand the future means of production.

Figure 2 displays Private Investment and Government Spending as a share of U.S. national income. These too are highly correlated. Society's current income is limited. When governments spend more of a society's income, the private sector spends less. Reducing private sector spending reduces the share of national income available for private investment and slows economic growth.

Figure 3 displays Private Investment and Government Borrowing as a share of U.S. national income; Figure 4 displays Private Savings and Government Borrowing as a share of U.S. national income. A society's savings represent all of the real income that is available for anyone to borrow. When government borrows from this pool, there is less for the private sector to borrow<sup>4</sup>.

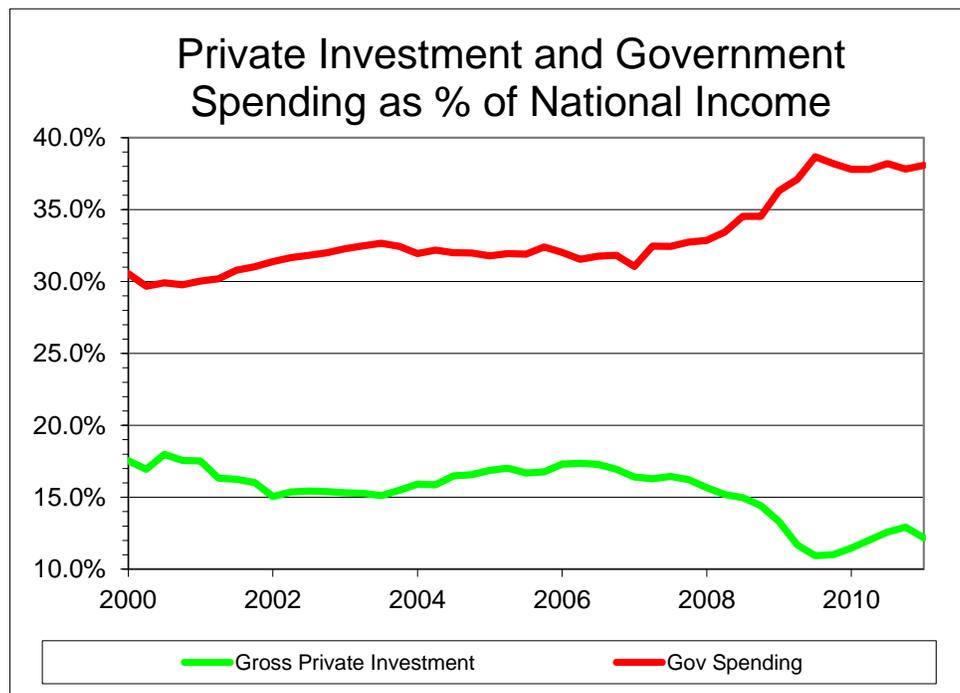


Figure 2: Private Investment and Government Spending as a Share of U.S. National Income<sup>5</sup>

<sup>4</sup> Society's savings as opposed to a nation's savings are referred to in order to avoid a discussion of foreign versus domestic savings. U.S. data for government borrowing and private investment include international transfers. For the wider message of this discussion, international transfers are secondary in nature.

<sup>5</sup> Bureau of Economic Analysis, NIPA Table 5.1 Line 23 for Gross Private Domestic Investment, Table 3.1 Line 33 for Total Government Expenditures and Table 1.7.5 Line 28 for Gross National Income.

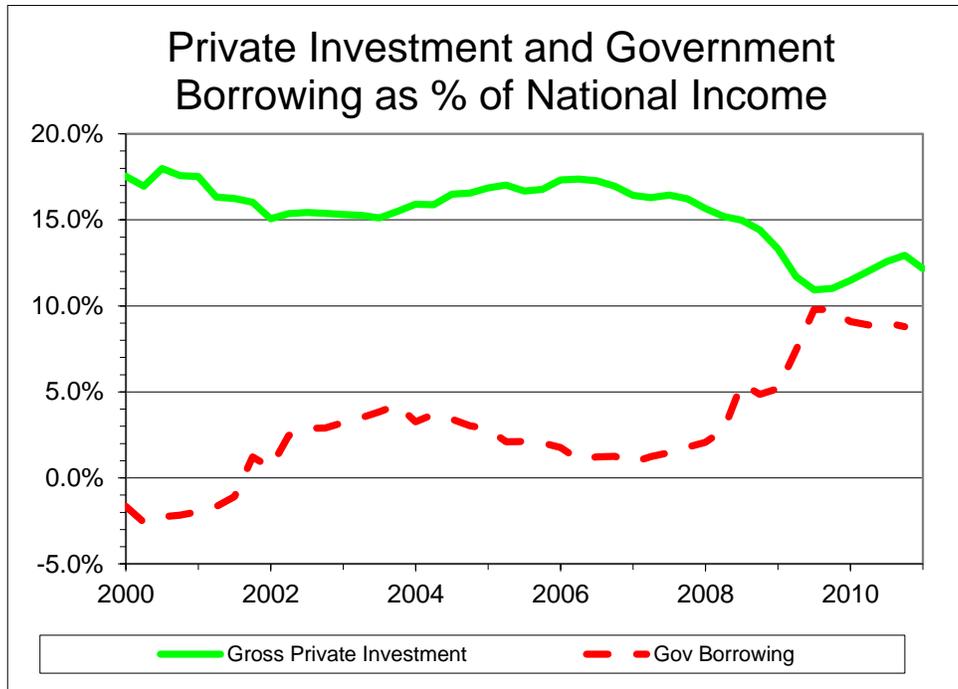


Figure 3: Private Savings, Private Investment and Government Borrowing as a Share of U.S. National Income.<sup>6</sup>

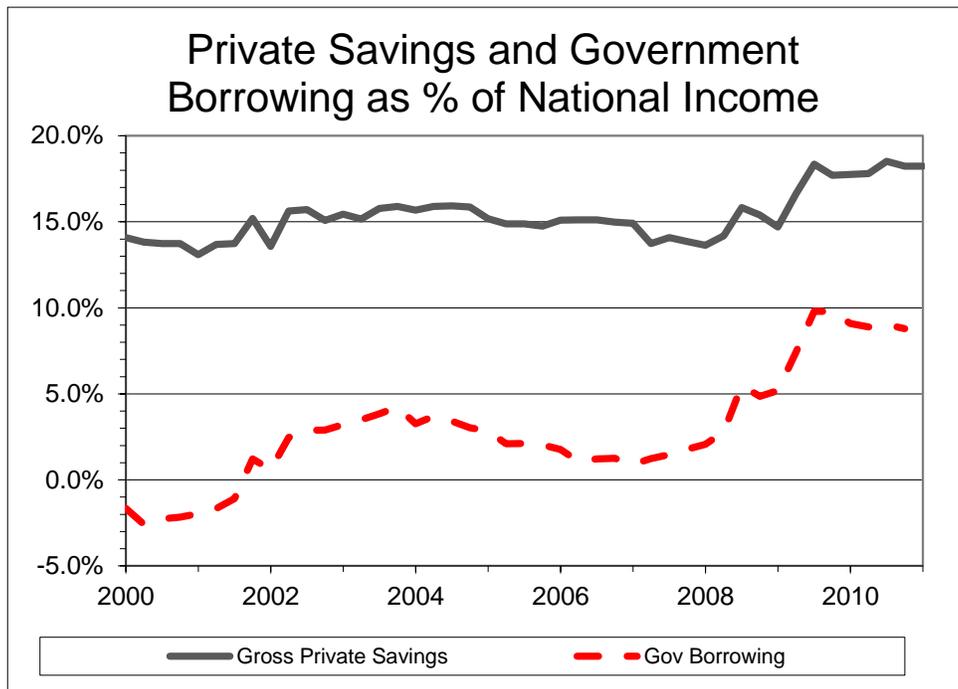


Figure 4: Private Savings and Government Borrowing as a Share of U.S. National Income.<sup>7</sup>

<sup>6</sup> Bureau of Economic Analysis, NIPA Table 5.1 Line 23 for Gross Private Domestic Investment, Table 5.1 Line 11 for Net Government Savings (borrowing) and Table 1.7.5 Line 28 for Gross National Income.

## 1.2 Recessions

A recession occurs when some portion of current capital and labor can no longer generate income. There are many possible causes for this, but over-investment is a common one. If this loss of income is sufficiently large, large enough that the existing investment pipeline cannot replace it quickly, a re-enforcing process develops where the ultimate decline in income is greater than the initial losses<sup>8</sup>. However, these declines will stabilize at some point, and new investment can then drive real income back upward.

The “Great Recession of 2008” was initiated by over-investment in the housing sector. At some point, capital and labor in this sector could no longer generate prior levels of income and this initiated a downturn. In this recession, the economy’s natural recovery mechanisms were hindered by government actions. Government borrowing diverted the flow of savings away from private investment. This slowed the rate of capital accumulation and hindered the economy’s ability to create new jobs. As a result unemployment went higher than it would otherwise have been, and the recovery has been slower than it would otherwise have been.

Figure 4 shows that private savings in the U.S. increased in 2008 and 2009 as the losses from the “Great Recession” mounted. Government stepped in to redirect this rise in savings back toward consumption through the American Reinvestment and Recovery Act (ARRA) and to make whole bank losses with the Trouble Asset Relief Program (TARP). Allocating society’s savings toward government directed consumption via ARRA lowered the nation’s effective savings rate: as if the original income were never saved at all. Allocating society’s savings to boost the reserves and profits of failing banks made whole past losses for some but at the expense of private investment and future income for others. Walter Bagehot once observed “that any aid to a present bad bank is the surest mode of preventing the establishment of a future good bank.”<sup>9</sup> The opportunity cost of ARRA and TARP was private investment and future income.

But for the rise in savings, private investment would have fallen further and unemployment would have been higher. But for the rise in government borrowing, private investment would have been higher and unemployment less.

---

<sup>7</sup> Bureau of Economic Analysis, NIPA Table 5.1 Line 44 for Gross Private Savings, Table 5.1 Line 11 for Net Government Savings (borrowing) and Table 1.7.5 Line 28 for Gross National Income.

<sup>8</sup> Bagehot, Walter, “Lombard Street: A Description of the Money Market”, 1873, Kindle Edition Location 1369 – 1382 – provides a very good description of this re-enforcing process.

<sup>9</sup> Bagehot, Walter, “Lombard Street: A Description of the Money Market”, 1873, Kindle Edition Location 1152

### 1.3 Government vs. Private Investment

The impact of investment on production and economic growth is not strictly a function of its magnitude. Investments have an associated quality and productivity. Here, investment quality is defined as the return: the incremental increase in income associated with an incremental increase in investment. This is Keynes' multiplier<sup>10</sup> as discussed in his "General Theory". Investment productivity is defined here as the speed with which an investment affects income: over what time frame does the investment affect production.

Not all investments are equal in quality and productivity. This is why government investment cannot compete with private investment to grow the economy. Private investment has a means to measure quality: profit. Profits are an indication that society values a good more than the cost to produce that good. There is no means to measure the quality of most government investments.

A market economy is an emergent system. The entrepreneur is analogous to the mutation in biology. They drive economic evolution by presenting new products into the marketplace. The subjective desires of the consumer determine which new products succeed and which fail. In a free market, the entrepreneur cannot force or coerce the consumer; they must provide value to obtain profits. Governments operate in a different world, that of force and coercion, not freedom to exchange – or not.

Because of the importance of private investment for economic and employment growth, changes in government spending tend to be correlated with changes in economic growth. Large increases in government spending tend to be associated with slower economic growth while large decreases in government spending tend to be associated with higher economic growth.<sup>11</sup> Figures 2, 3 and 4 largely explain this observed correlation, changes in government spending and borrowing shift the allocation of current income driving changes in private investment. These changes in private investment alter the path of capital accumulation affecting economic and employment growth.

### 1.4 Monetary Inflation

General price inflation, or deflation, is driven by changes in the value of the medium of exchange, money<sup>12</sup>. Because employment is driven by economic growth, which is in turn driven by private investment, and not the money supply per se, any combination of inflation and unemployment can exist. The Phillips Curve<sup>13</sup> where inflation and

---

<sup>10</sup> Keynes, John Maynard "The General Theory of Employment, Interest, and Money", Prometheus Books, New York, 1997, Chapter 10

<sup>11</sup> Alesina, Alberto & Silvia Ardagna, "Large Changes in Fiscal Policy: Taxes versus Spending", NBER Working Paper No. 15438, October 2009

<sup>12</sup> Friedman, Milton "Money Mischief", Harcourt Brace, New York, 1992, p. 193

<sup>13</sup> Phillips, Alban W., "The Relation Between Unemployment and the Rate of Change of Money Wages in the United Kingdom, 1861-1957", *Economica*, Vol. 25, No. 100 (Nov., 1958), pp. 283-299

unemployment are inversely related is a special case of where private investment and inflation are positively correlated. But, inflation and private investment need not be positively correlated.

## **1.5 Stability**

By definition an investment is an explicit trade between current consumption and future consumption. To make this trade, an individual must have some faith that forgoing current consumption will in fact result in additional future consumption. This faith is driven by expectations about the future.

Expectations about future conditions are commonly driven by past experience. The most common forecast is a simple extrapolation of recent history. This is where stability becomes important.

Stability in the value of money, in the rule of law, in property rights makes it more likely that the future will play out as expected. Instability, or volatility, will make it less likely.

Instability in the value of money, in the rule of law, in property rights reduces private investment because it introduces uncertainty as to whether trading current consumption for future consumption will payout: i.e., will generate profits.

## **2. Proposal**

The proposals that follow focus on promoting private investment as a means of enhancing economic growth and employment. The primary mechanisms put forth are to restrict government's involvement in the U.S. economy and to encourage private savings and investment.

### **2.1 Near-Term Policy Recommendations**

#### **2.1.1 Government Spending**

- I. Reduce spending by the Federal Government by 5% per year for five years or until the Federal Government is running surpluses, whichever is longer.
- II. Beyond this timeframe, limit spending growth by the Federal Government to no more than the population growth rate until the public's debt is reduced to less than 20% of national income and spending by the Federal Government has moved toward sustainable levels.
- III. Over time, downsize the spending of all government in the United States (Federal, State and Local) toward 20% to 25% of the nation's income.

#### **2.1.2 Taxes**

- I. Scrap all current federal income and payroll taxes.
- II. Replace current federal income and payroll taxes with a flat tax of 10% applied to:
  - a. All individual income: wages and investment income.
  - b. All firm, business and corporate profits on operations within the United States.
    - i. Do not tax foreign profits by firms, businesses and corporations.
    - ii. Tax dividends as individual income, not corporate profit.
  - c. No deductions of any kind.
- III. Tax carbon dioxide emissions at a rate between \$100 and \$200 per ton of CO<sub>2</sub> emitted.
- IV. Tax inheritance at the income tax rate of 10%.
  - a. Tax inherited cash upon receipt.
  - b. Tax non-cash inherited assets if and when liquidated: i.e., sold.
  - c. Set the tax basis for all inherited assets to zero: treat the full value as income when sold.

## **Comment:**

The primary objective of these tax proposals is to limit the taxing of income and property so as to promote the creation of future income via private investment and capital accumulation. A secondary objective is to shift some taxation toward consumption type taxes via a carbon dioxide emissions tax.

### **2.1.3 Social Security**

- I. Transform social security from a transfer scheme to an asset back system.
  - a. Over a twenty to thirty year timeframe, phase out the current system and shift to an individually owned retirement account system.
- II. Encourage individual retirement accounts.
  - a. Allocations from after tax income with no annual limits.
  - b. Investment returns not taxed.
  - c. All withdrawals after age 65 not taxed.
  - d. Withdrawals prior to 65 taxed at 10%.
  - e. Account is inheritable.
    - i. Inherited retirement accounts not taxed if rolled into receivers retirement account.
    - ii. Inherited retirement accounts taxed at 10% if not rolled into receivers retirement account.
  - f. Allow parents to create accounts for children under the age of 21.
- III. Limit transfer type payments to low income and low wealth individuals.

### **2.1.4 Healthcare**

- I. Transform health care from a predominately third party payer system to an individually managed system.
  - a. Scrape the Patient Protection and Affordable Care Act.
  - b. Allow individuals to purchase health insurance across state lines.
  - c. Encourage states to reduce restrictions on health insurance products that can be offered.
  - d. Transform Medicare and Medicaid to defined contribution plans.
    - i. Benefits can be used to purchase: health care, health insurance or deposit in a health savings account.
    - ii. Over time, eliminate Medicare, shifting low income and low wealth individuals of all ages toward Medicaid.
    - iii. Over time, push Medicaid to lower levels of government: state and local, eliminating federal involvement.
- II. Encourage the accumulation of income generating assets to finance health care.
  - a. Allow all individuals to create health savings accounts.

- i. Allocations from after tax income with no annual limits.
- ii. Investment returns not taxed.
- iii. Withdrawals for medical related expenses not taxed.
- iv. Withdrawals for non-medical expenses taxed at 10%.
- v. Accounts are inheritable.
  - 1. Inherited accounts not taxed if rolled into receiver's health savings account.
  - 2. Inherited accounts taxed at 10% if not rolled into receiver's health savings account.
- vi. Allow parents to create accounts for children under the age of 21.

**Comment:**

Programs like Social Security and Medicare and Medicaid create their own demand. These transfer programs reduce the amount of private income that can be allocated toward savings and investment. Over time, the accumulated losses in economic growth increase the demand for such services. Gradually shifting toward a savings based system will eventually eliminate much of the need for government expenditures on these types of programs. The accumulation of additional economic assets will not only enable individuals to finance these needs themselves but create a larger economy than the current system.

**2.1.5 Money**

- I. Stabilize the value of the United States Dollar on a century timeframe.
- II. Require that the Federal Reserve Note be managed by a fixed, actionable decision rule, known to the public.
  - a. For example, the Taylor Rule.
  - b. Congress should specify said rule in law.
  - c. No ad hoc management should be allowed, at any time.
- III. Alternatively, retire the Federal Reserve Note and return to commodity money.

**Comment:**

It may be that stability in the value of money is of greater value for private investment, economic growth and employment than any effect from the active manipulation of the money supply. In theory, a fiat currency could be managed for stability in value, but the Federal Reserve Note has not been managed in this fashion. Gold and silver have historically retained value in relation to other goods and this has been demonstrated on a time scale of centuries.

## 2.2 Long-Term Structural Reforms

*“A free and enlightened people, ..., will not resign all their rights to those who govern, and they will fix limits to their legislators and rulers.”*

*The Federal Farmer*<sup>14</sup>

The original Bill of Rights amended the U.S. Constitution so as to safe guard individual rights and freedoms by placing restrictions on the authority and power of the Federal Government. The following amendments to the U.S. Constitution are put forth as structural reforms intended to restrict the authority and power of the Federal Government over economic matters. These are not necessary to implement the policy proposals suggested but would likely be useful for maintaining these policies on a generational timeframe.

### **Suggested Amendments:**

- I. Congress may spend no more than ten percent of the nation’s income.
  - a. Congress may exceed this limit in a given year only with a declaration of war and with the approval of a majority of States by the passage of state law.
  - b. Congress shall not exceed this limit more than five years out of any twenty.
  - c. Congress shall adjust its appropriations to abide by this amendment within ten years of passage.
  
- II. The 16<sup>th</sup> Amendment is hereby limited. Congress shall tax no more than ten percent of an individual’s income or of a firm, business, or corporation’s profit. Income may be taxed from the individual or the firm, business or corporation, not both.
  
- III. Congress shall appropriate no funds to acquire full or partial ownership of a private or public firm, business or corporation. Congress shall appropriate no funds for loans to private or public firms, businesses, or corporations. Congress shall not obligate the United States to guarantee the debts of any private or public firm, business or corporation. Congress shall appropriate no funds to any private or public firm, business or corporation other than for the acquisition of goods and services required for the operation of government.
  - a. Any full or partial ownership of a private or public firm, business or corporation shall be terminated within two years of the passage of this amendment.
  
- IV. The United States Dollar is One Troy Ounce, or 480 grains, of Silver.
  - a. The United States shall mint silver and gold coins of various weights in support of commerce within the United States.
  - b. Seigniorage shall not be charge for citizens or foreign residents paying taxes to the United States.

---

<sup>14</sup> Lee, Richard Henry “Letters from the Federal Farmer to the Republican”, II, October 9, 1787

- c. Congress shall pass no law designating legal tender.
- d. Congress shall not print or issue money.
- e. Taxes may be paid in United States Dollars, gold coin or bank notes or deposits backed thereof.
- f. The people retain the right to determine the value of all goods and services in United States Dollars, including gold coin.

### 3. Simulated Policy Outcomes

In this section, estimates for future employment and economic prosperity are presented for three scenarios that vary the growth of government spending. These simulated scenarios are generated from an economic growth model originally designed to investigate how TARP and ARRA might affect capital accumulation, income and employment. This model is sufficient for rough estimates of employment and unemployment resulting from changes in government spending and borrowing.

Table 1 details the patterns for the growth of government spending in the three different scenarios: Grow 5, Freeze, and Cut 5. For all three scenarios, the working population is growing at 1% per year and the money supply is growing at 4% per year. For the Freeze and Cut 5 scenarios, spending growth is resumed at the population growth rate after government spending comes into a surplus. Table 2 specifies the years these scenarios reach a surplus. Table 3 provides a summary of output for employment and real wages. Table 4 displays the average rate of productivity growth for the three scenarios. Graphical output for a variety of indicators is provided at the end of this section.

Year	Government Spending Growth Rate (%/Year)		
	Grow 5	Freeze	Cut 5
2011	5%	5%	5%
2012	5%	0%	-5%
2013	5%	0%	-5%
2014	5%	0%	-5%
2015	5%	0%	-5%
2016	5%	0%	-5%
2017	5%	0%	1%
2018	5%	1%	1%
2019	5%	1%	1%
2020	5%	1%	1%

Table 1: Scenario Definitions for Government Spending

Fiscal Year Government Budget Balances		
Grow 5	Freeze	Cut 5
????	2017	2015

Table 2: Simulated Year for Government Surplus

Year (Jan)	Employment (Millions of People)			Unemployment Rate (% Labor Pool Unemployed)			Real Wages Relative to 2011 (Current Wages 2011\$/2011 Wages)		
	Grow 5	Freeze	Cut 5	Grow 5	Freeze	Cut 5	Grow 5	Freeze	Cut 5
2011	139	139	139	9.1%	9.1%	9.1%	1	1	1
2012	142	142	142	8.5%	8.5%	8.5%	1	1	1
2013	146	146	146	7.1%	7.1%	7.1%	1.01	1.01	1.01
2014	149-	149	149+	6.9%	6.8%	6.6%	1.01	1.01	1.01
2015	149	150	151	7.9%	7.3%	6.8%	1.02-	1.02	1.02+
2017	152	156	158	7.7%	6.2%	5.4%	1	1.02	1.04
2019	162	166	167	4.8%	3.9%	4.1%	0.98	1.04	1.09
2021	168	170	170	5.3%	5.1%	5.1%	0.98	1.09	1.14

Table 3: Simulated Employment and Relative Real Wages

Average Annual Productivity Growth Rate		
Grow 5	Freeze	Cut 5
-0.2%	1.0%	1.5%

Table 4: Simulated Average Annual Productivity Growth

Employment recovery is apparent in all three scenarios. What primarily varies across the scenarios is the speed with which employment grows, the rate of productivity growth and the growth of real wages and real income. The driver for this variation is the share of national income allocated toward private investment. Variations in government spending affect private investment because both are competing for a share of the same resource: income. This is especially true when government is running a deficit as government borrowing is in direct competition with businesses for access to society's savings.

Table 4 provides a summary of the average productivity growth rates seen in the three scenarios. The different trajectories for private investment shown in Figure 12 drive the variation seen in productivity growth and subsequently employment and wages. By shifting income to government, the Grow 5 scenario slows the accumulation of new capital. Labor substitutes for capital to grow production but in doing so, the average productivity of labor declines somewhat. In this scenario, government spending starves the private sector for investment; employment grows because real wages and living standards are driven downward making labor relatively less expensive. Returns on assets rise but to no avail as savings are simply not available for private sector investment. By shifting income to the private sector, the Freeze and Cut 5 scenarios are able to accumulate more and newer capital that gradually increases the productivity of the workforce. This creates a re-enforcing process where more future real income is available for investment as more capital is accumulated and more goods are produced and exchanged. Not only is more of the labor pool employed, but the labor pool is larger because more of the working population is pulled in. Real wages rise with employment because private investment drives the accumulation of new capital enabling more to be produced per unit of labor.

All three scenarios converge toward similar unemployment rates; the absolute variation in simulated employment is about 2 million people by 2021. However, the three scenarios converge toward very different futures with regard to living standards. In the Grow 5 scenario, nominal growth drives employment but after ten years workers have lower real wages. Economically, society is stagnating. In the Cut 5 scenario, private investment drives the accumulation of new, more productive capital that employs more people and at higher real wages. Economically, society is prospering.

Growing private investment is the only mechanism that can grow both employment and living standards. Because current real income is limited, it will be difficult, if not impossible, to grow real private investment in the United States without curtailing government. It will be impossible to grow both employment and living standards without increasing real private investment.

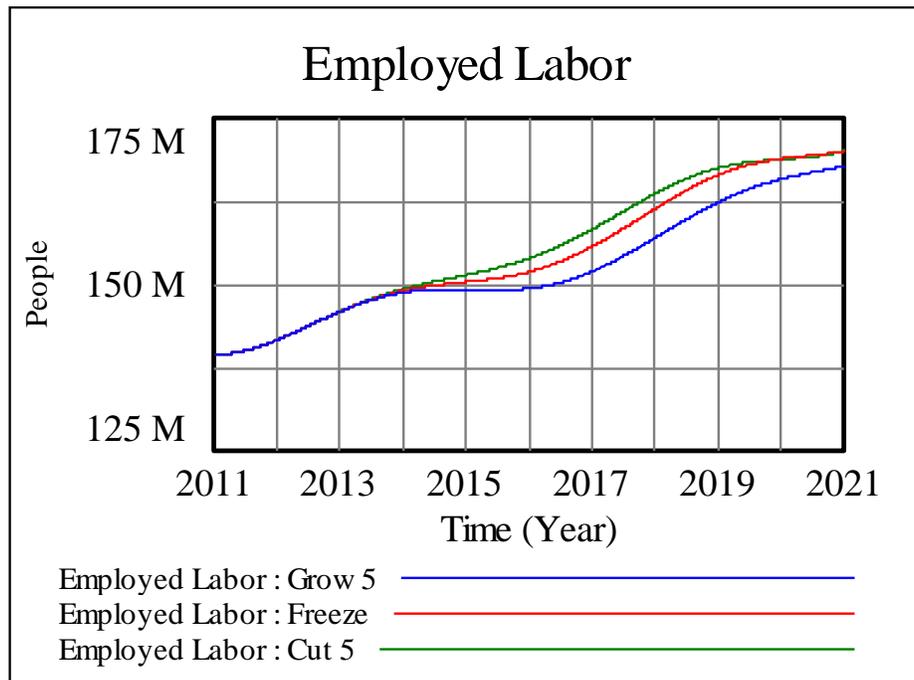


Figure 5: Simulated U.S. Employment

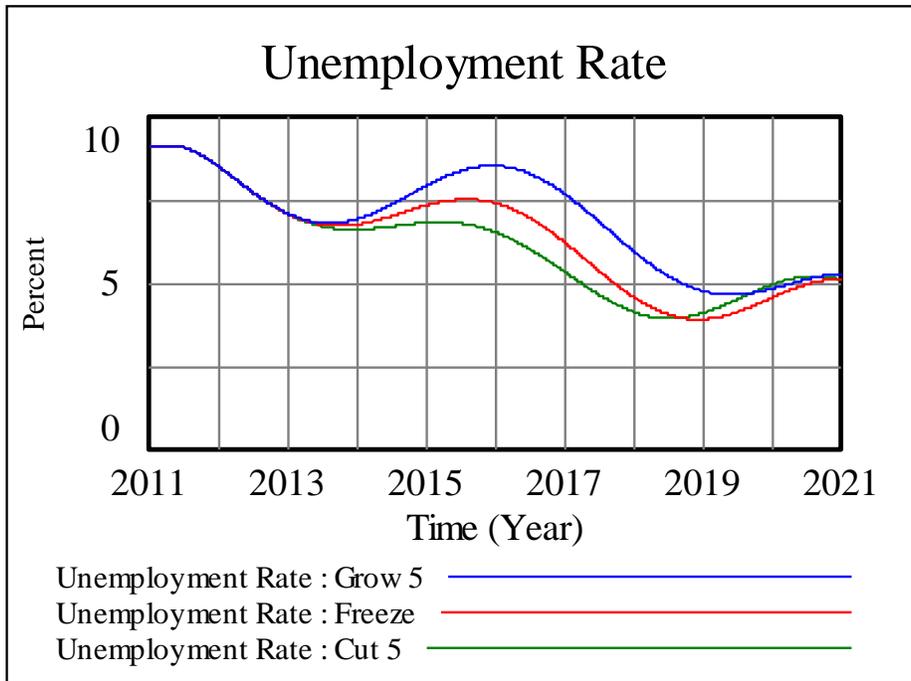


Figure 6: Simulated U.S. Unemployment Rate

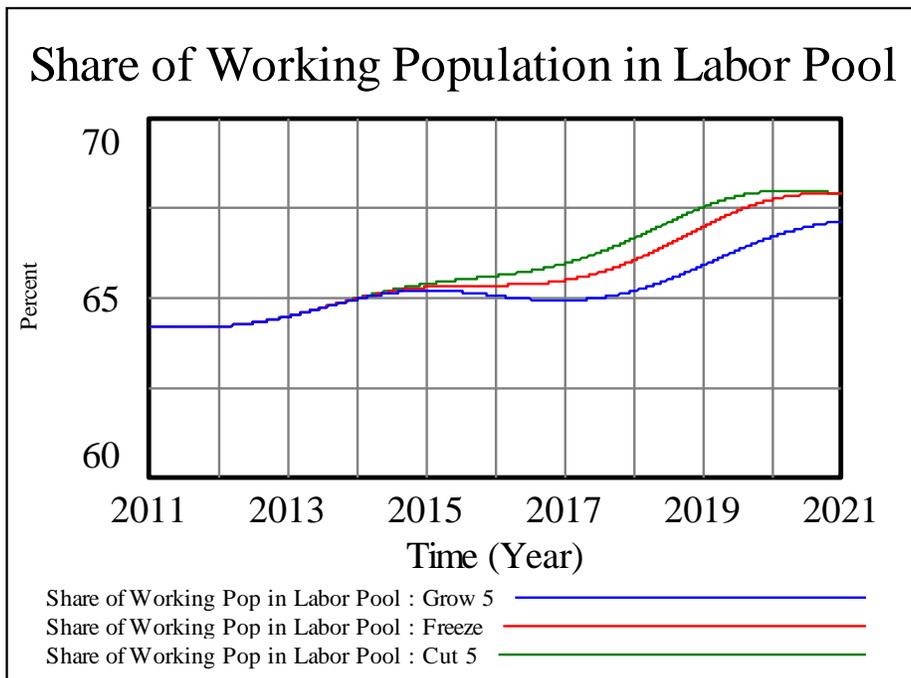


Figure 7: Simulated Share of the U.S. Working Population in the Labor Pool (Working or seeking Work)

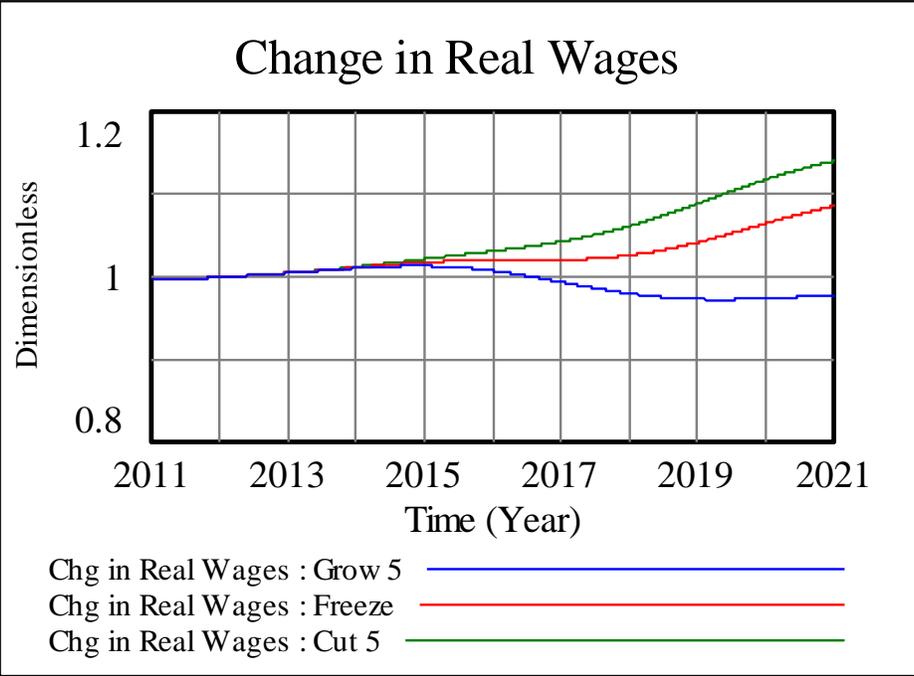


Figure 8: Simulated Changes in Real Wages

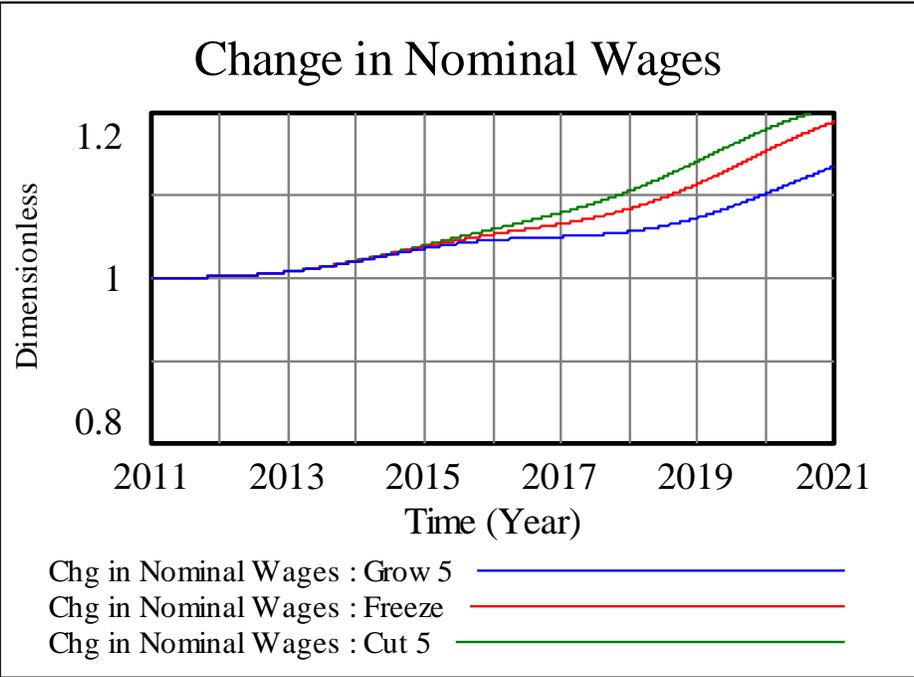


Figure 9: Simulated Changes in Nominal Wages

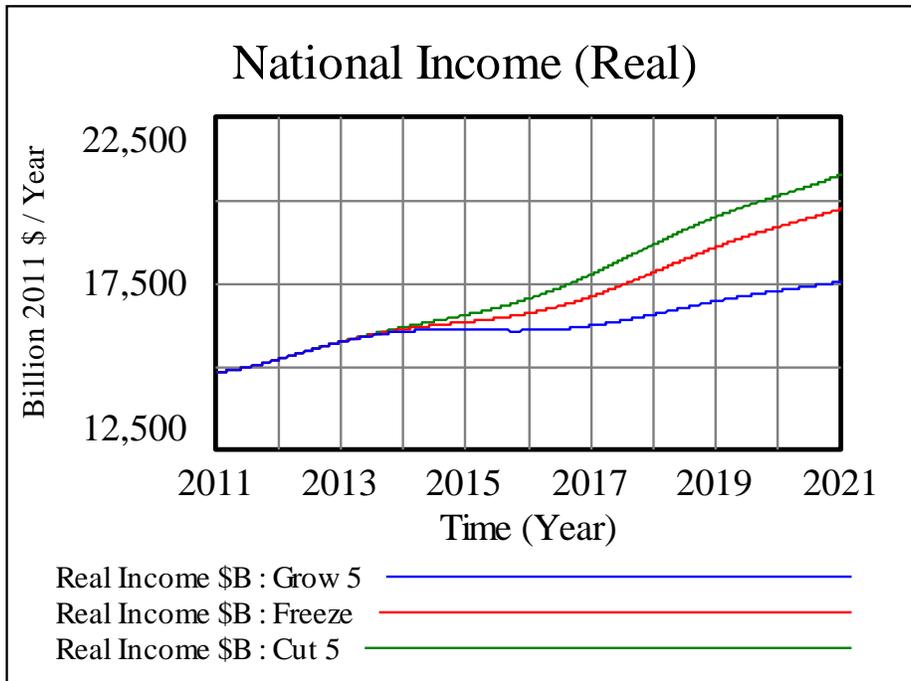


Figure 10: Simulated National Income in 2011\$

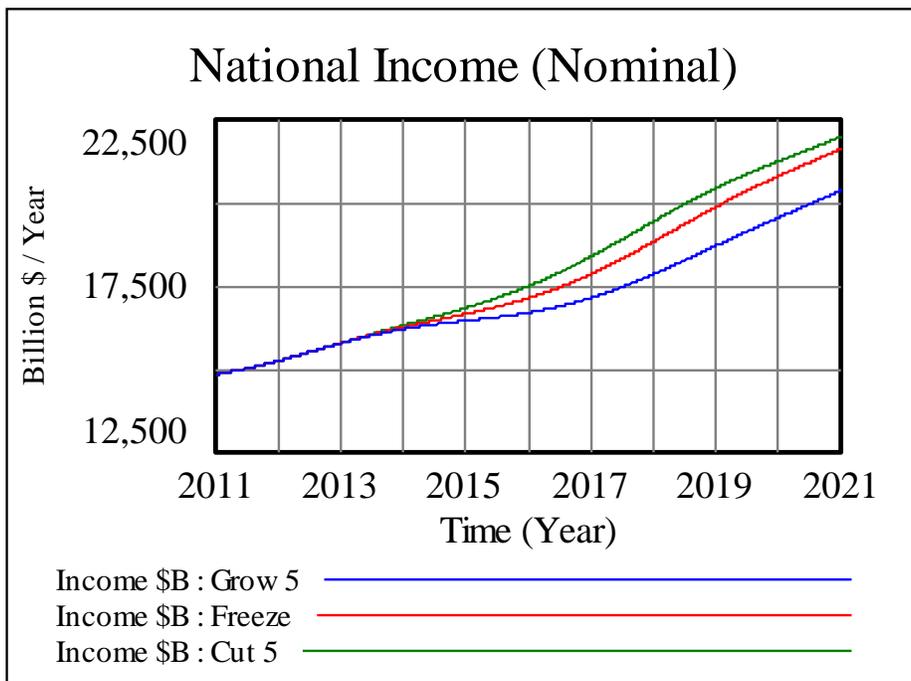


Figure 11: Simulated National Income in Nominal \$

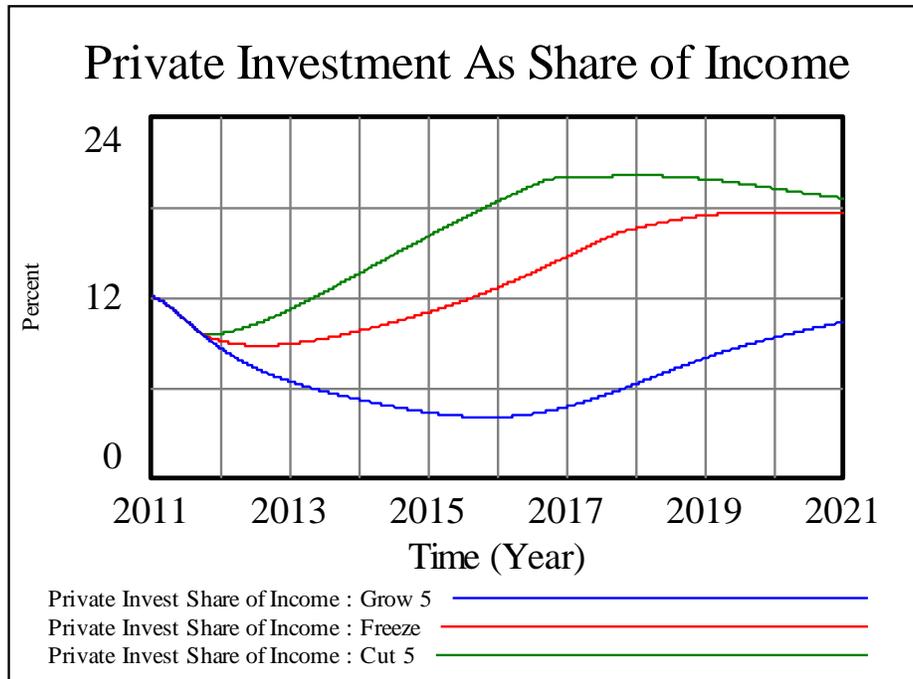


Figure 12: Simulated Private Investment as a Share of National Income

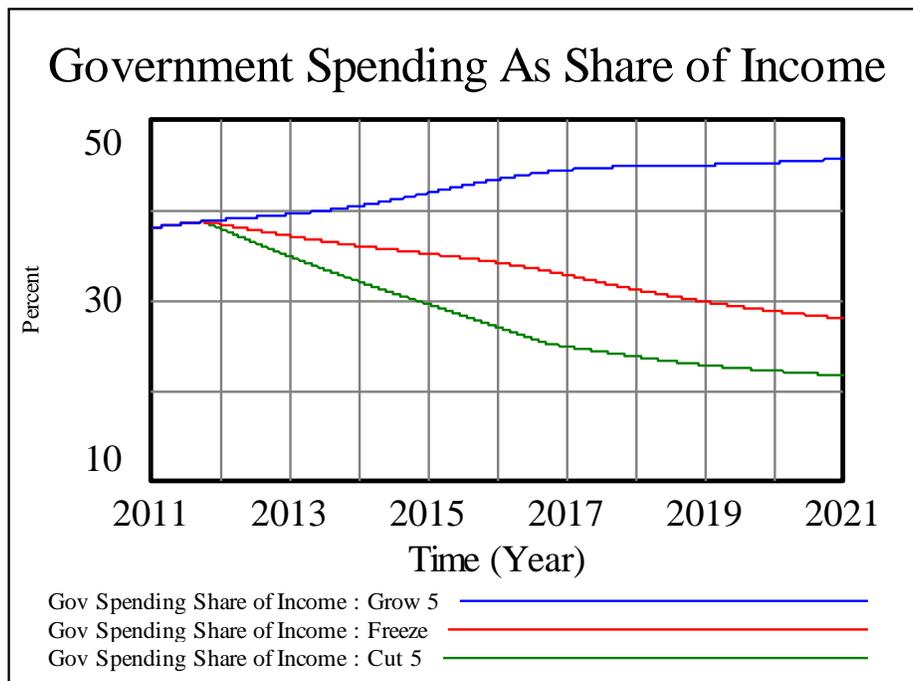


Figure 13: Simulated Government Spending as a Share of National Income

## 4. Conclusions

Government spending in the United States is lowering the effective saving rate of the nation. It alters the allocation of income away from private investment and toward consumption. This slows economic growth and limits the growth of future jobs.

Free people are prosperous because free men and woman own themselves, their property and the fruits of their labors. This incentivizes free men and women to save and invest their income in order to build a prosperous future for themselves and their posterity.

Our future path is uncertain. We may choose a prosperous path, with a growing economy and rising employment, but this will require expanding private investment, as private capital drives the production process. It will be difficult, if not impossible, to increase private investment without curtailing government: not just holding the status quo but actually reducing the share of national income spent by government. Near-term income and, hence, spending are limited: any increase in near-term government spending reduces private spending. Future income and spending can grow, or decline. But growing the economy requires investment – private investment.

Government spending per se is not investment. In fact, the vast majority of government spending is consumption oriented. Government spending and investment can be supportive of private economic activity. Indeed, some level is likely critical to the creation of a private economy, but government spending cannot substitute for private investment.

Given the size and scale of government in the United States today, reducing government's role in the economy will be a monumental undertaking. Nevertheless, endeavors of such scale have been accomplished before, including the very creation of this nation. In fact, the adoption of the United States Constitution can serve as a road map for returning to a more limited form of government. The campaign to adopt the U.S. Constitution included a significant public debate held at a very high level of discourse. Our times require a similar level of discourse on the appropriate role of government in society. One aspect of this debate should be a public discourse on the basic mechanisms of economic growth and the role that private investment and capital accumulation play in this growth. Such debates may now be taking place among economist, but they have not been taken to the people and must be. Our public discussions on economics and the role government plays are often at the level of a child. Our founding fathers rose to a much higher standard. The American people today are no less qualified to participate in a reasoned debate of political economy than were our forefathers. What is lacking is the presentation. If we are truly a free society, the path forward will be supported from below and not dictated from above. We would all do well if an intellectually honest and well-reasoned case for economic growth were taken to the public.