Hello Everyone,

*“A government that robs Peter to pay Paul can always count on the support of Paul.”* George Bernard Shaw, Irish Playwright.

Today’s missive obliquely wonders if government stimulus is encouraging the proliferation of Pauls. If so, uh oh.

We will start with George Washington and end with drunken sailors. I hope this series…yes, a new series…will help make you better investors.

Signed, Your On-Thanksgiving-Are-Turkeys-Thankful-For-Vegetarians? Financial Advisor,

Greg

# KKOB 2020.11.20 George Washington & GDP

**Bob:** So, Greg, my understanding is you want to talk about the Revolutionary War…and then connect it to today’s economy. Is that right?

**Greg:** Yes. And I know that sounds kind of odd. But hang with me and I think you will see the connection.

This may surprise you, but we have economic statistics in America that go back to the early 1780’s. We even have records from immediately after General Washington defeating the British at Yorktown. Pretty cool.

Anyway, 240 years ago, approximately 3% of America’s Gross Domestic Product (our economy) was attributable to government spending. That meant 97% of our economy was driven by the private sector.

In short, despite the costs of the Revolution, prosperity was rising because individuals (and small-to-medium sized businesses) were creating wealth.

Let's now spring forward to the Civil War. As you might guess, government spending exploded higher for both the North and the South. Yet, even as that life-and-death struggle was occurring, government spending as a percentage of our GDP was only 10%. Thus, 160 years ago, the private sector still comprised 90% of our economy.

**Bob:** And my guess is ---after the Civil War--- government spending probably fell back to below 10% of the economy.

**Greg:** You're correct. But it fell back to a higher level than it was prior to the war. And this will be a continuing pattern. Government spending will naturally rise during a crisis. Then once the crisis passes, it will fall back…but to a higher pre-crisis level.

So, let's now leap ahead to 1913. This is not a war year; but it is the year when the Federal Reserve Bank was chartered. And this will prove to be a huge inflection point with respect to government's role in the GDP.

You probably remember, America entered World War I in 1917. That prompted government spending as a percentage of GDP to rise to 30%! Power was becoming more centralized…both in government and banking circles. For the first time in our history, the private sector was forced to pay attention to government actions.

Then came 1941 and World War II.  Our entire nation was mobilized to fight in Asia and Europe.  Yet, even with that, government spending with respect to GDP rose to only 50%.  And, of course, after the war that percentage dropped, but again to a higher plateau.

**Bob:**  So, I think I know where you are going with this.  I have no idea what percent of our GDP is attributable to government spending today.  But in the wake of Covid, it must be high.

**Greg:**  Right again.   According to some excellent analysis by economist George Gammon, we are nearing 57% of our GDP being driven by government spending.  That means only 43% of our economy comes from the private-wealth-producing sector.

So, there are a few of takeaways from this:

- If you are wondering why so few people are outraged at the shutdowns, wonder no longer.  Government never shut down.
- Next, the stimulus checks ---coupled with unemployment benefits-- actually led to a rise in average incomes.  No outrage there.
- Next, if you think a rising GDP reflects ***economic health***, I would argue otherwise.
- Any government can inflate the GDP by spending like a drunken sailor.  They can then point to GDP growth as proof their policies are working…but it's an illusion.

**Bob:** So, what you are really saying is not all GDP growth is the same. Economic growth that comes from building new factories and equipment is far better than just printing money and asking people to spend it.

**Greg:** Exactly. It is ***not the quantity*** of the GDP that matters. If that were true, the Soviet Union would be an international powerhouse. It ***is the quality*** of GDP we should focus on. And having less than 50% of our GDP coming from the private sector---when we are not even at war---is concerning. But it is also helpful in understanding why we are behaving as we are.

So, let's pick this up again on Monday and I'll go into more detail.

**Bob:** Sounds good. Until then, how do people reach you?

**Greg:** My number is 250-3754. Or go to my website at zanettifinancial.com.

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