

# Does the Party in Power Matter for Economic Performance?

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## Introduction

A significant number of voters in the United States appear to believe that the economy has historically performed better when the Republican party is in charge of the country. The Club for Growth, for example, supports Republican candidates, especially those who endorse reducing the size and economic role of government, on the assumption that these policies favor faster economic growth. At least since the Truman Administration, Republicans have been very effective at convincing many voters that the Democratic party follows policies that expand the role of government, and that these policies reduce economic growth. But just as 2004 polls showed that a large number of voters believed that Saddam Hussein's government participated in the terrorist attacks of 9/11, the commonly held beliefs about party policies may make perfect sense, but are nonetheless unsupported by any evidence.

In this brief paper, I review standard government statistics on economic performance during the postwar period in order to determine whether these beliefs have any basis in fact. The Republicans may claim to be more competent at economic management, but does the economy grow faster when Republicans are in charge? Does the size of the government actually keep expanding, and if so are Democrats the cause? Does bigger government lead to slower growth? Is it accurate to characterize Democrats as the "tax and spend" party? To those who have never considered the data before, the results may seem surprising.

## Does the economy grow faster when Republicans are in charge?

The Department of Commerce's Bureau of Economic Analysis (BEA, 2006) has collected annual data since 1929 for the National Income and Product Accounts. If we use these data through 2005 to compare economic performance during Democratic and Republican administrations, the contrast, as shown in Table 1, is dramatic:

<b>Annual Averages</b>	<b>Democrats</b>	<b>Republicans</b>
Real GDP Growth Rate	5.1%	1.9%
Real GDP Growth Per Capita	3.8%	0.7%

Including the Great Depression and the Second World War in the comparison period is likely, however, to distort the results. Thus, for the rest of this paper I will use data since 1949, after President Truman's first term. Furthermore, additional data, such as monthly unemployment data from the Bureau of Labor Statistics (BLS, 2006), is available after 1948.

A brief review of the data for the Clinton Administration and the current Bush Administration shows striking differences in performance. Though there is disagreement about the causes, the economic data strongly supports that the economy performed better during the Clinton Administration than under the current Bush Administration, as illustrated in Table 2. Under President Clinton, real GDP grew faster on average than under President Bush, even though we use data through the end of 2005 in order to include the recent economic recovery, and the contrast is even greater if we adjust for population growth. The difference in the average unemployment rate was small, but the unemployment rate fell

from 7.3% to 4.2% during the eight years of the Clinton Presidency, an average of 0.4% per year, while under President Bush unemployment rose to 6.2% by mid-2003 before falling back to 4.7% as of the most recent data for April, 2006.

<b>Annual Averages</b>	<b>Clinton</b>	<b>Bush</b>
Real GDP Growth Rate	3.7%	2.6%
Real GDP Growth Per Capita	2.5%	1.6%
Unemployment Rate	5.2%	5.4%
Change in Unemployment Rate	-0.4%	+0.1%

Is the current Bush administration an anomaly? As Table 3 shows, data from 1949 to 1992 suggest that even before 1993, the economy did not perform better under Republican administrations. Growth was higher under Democrats, while unemployment was, on average, lower and falling.

<b>Annual Averages</b>	<b>Democrats</b>	<b>Republicans</b>
Real GDP Growth Rate	4.5%	2.9%
Real GDP Growth Per Capita	3.1%	1.7%
Unemployment Rate	5.2%	6.1%
Change in Unemployment Rate	-0.3%	+0.3%

In Table 4, I combine the variables discussed above for an overall comparison, together with several additions. Adjusting for inflation with the Consumer Price Index (CPI), real weekly wages (available only through 2002) and the Dow Jones Industrial Average both grew faster on average under Democrats, even when we use logarithmic growth rates for the latter to adjust for its variability.<sup>1</sup> The BLS's index of multifactor productivity (available through 2001) grew under Democratic administrations at twice the rate as under Republican administrations. As a share of GDP, even corporate profits were higher under Democrats, most likely because the economy did better.

<b>Annual Averages</b>	<b>Democrats</b>	<b>Republicans</b>	<b>t-Statistic</b>
Real GDP Growth Rate	4.2%	2.9%	-2.90*
Real GDP Growth Per Capita	2.9%	1.7%	-2.72*
Unemployment Rate	5.2%	6.0%	+7.79*
Change in Unemployment Rate	-0.4%	+0.3%	+4.19*
Growth of Multifactor Productivity	1.7%	0.9%	-1.59
Corporate Profits (share of GDP)	10.2%	8.8%	-6.96*
Real Value of Dow Jones Index	5.4%	4.3%	-0.81
(in logarithmic growth rates)	4.4%	2.8%	-1.28
Real Weekly Earnings	1.0%	0.3%	-1.01
CPI Inflation Rate	3.8%	3.8%	1.37

Are these differences merely random? Table 4 also shows *t*-statistics, and in general a *t*-statistic greater than 2 (or less than -2) implies that the difference is statistically significant from zero at the 95% level of confidence (as marked with “\*\*”). A positive (or *negative*) *t*-statistic means that the value is higher (or *lower*) for Republicans.<sup>2</sup> The differences in growth, unemployment, and the corporate profit share are all statistically significant, and support the argument that the economy may actually perform better under Democrats. The differences in weekly earnings, stock market growth, inflation, and multifactor productivity all favor the Democrats as well, but these differences are not statistically significant.

Is there a lag effect? It is a reasonable argument that economic performance early in a new administration is likely to be the result of policies followed by the prior administration. For example, many economists believe that the recession of 1981-82 was caused more by the change in monetary policy enacted by Federal Reserve Board Chairman Paul Volcker, a Carter appointee, rather than any specific policy of President Reagan. I therefore tested whether lagging the effect of the administration on growth might support the argument that the economy actually performs better under Republicans. For quarterly growth rates of real GDP, the results are shown in Table 5 for up to sixteen quarters, along with the *t*-statistics.<sup>3</sup> Lagging up to three quarters, the Republican effect remains negative and significant. After a year the lagged effects become insignificant, and then become positive for 6 to 10 quarters, though the difference from zero is small and insignificant. After 10 quarters, the lagged effect remains insignificant but goes negative again. Even with up to four years of lagged effects, there is thus no evidence that the economy performs better under Republicans.

**Table 5**  
**Lagged Effects of Republicans on Quarterly Growth Rates**

<b>Annual Averages</b>	<b>Coefficient</b>	<b><i>t</i>-statistic</b>	<b>Annual Averages</b>	<b>Coefficient</b>	<b><i>t</i>-statistic</b>
No lagged effect	-0.38%	-2.90*			
Lagged 1 quarter	-0.43%	-3.26*	Lagged 9 quarters	0.08%	0.65
Lagged 2 quarters	-0.35%	-2.61*	Lagged 10 quarters	0.03%	0.22
Lagged 3 quarters	-0.28%	-2.07*	Lagged 11 quarters	-0.00%	-0.02
Lagged 4 quarters	-0.15%	-1.11	Lagged 12 quarters	-0.02%	-0.18
Lagged 5 quarters	-0.05%	-0.36	Lagged 13 quarters	-0.03%	-0.21
Lagged 6 quarters	0.06%	0.41	Lagged 14 quarters	-0.10%	-0.80
Lagged 7 quarters	0.07%	0.56	Lagged 15 quarters	-0.10%	-0.79
Lagged 8 quarters	0.12%	0.89	Lagged 16 quarters	-0.11%	-0.90

Is it the Administration or Congress that matters for economic growth? Because Congress writes the laws and sets the budgets, it is reasonable to argue that the Legislative Branch is more responsible for the state of the economy than the Executive. To test this, I estimated the different effects on real growth rates of Republican control of each house of Congress as well as for a Republican administration. These results were not significantly different from zero. I then tested for the effect of having both houses and the administration under simultaneous control of either party, relative to the effect of simply having a Republican administration. The effect of having Democratic control of government on growth was positive on growth and the effect of having Republican control of government was negative, but neither effect was statistically significant. The party of the administration is a better explanatory variable.

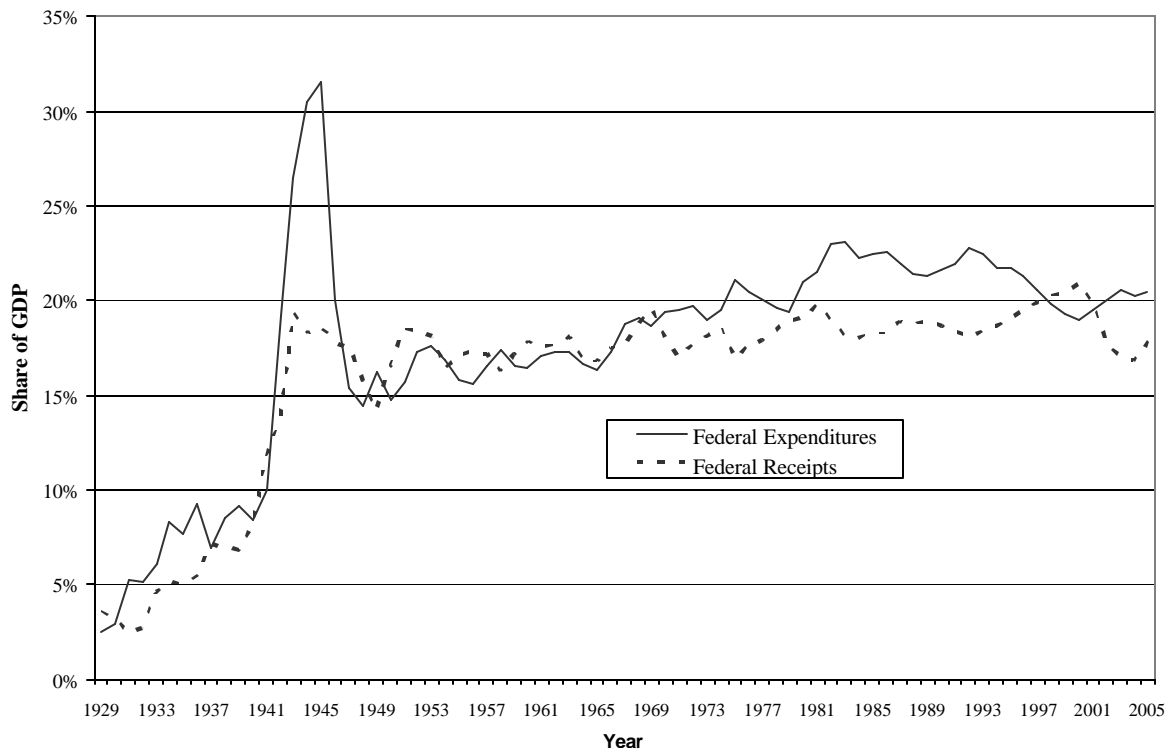
Statistical correlation does not scientifically prove causation, and these results do not prove that the economy does better under Democrats. But we can reasonably conclude that these government statistics provide evidence that directly contradicts the argument that the economy does better on average under Republican administrations. With lagged effects and other causes considered, the difference may be insignificant, but the economy may actually perform worse under Republicans.

## Does the size of the government keep expanding, and if so, are Democrats the cause?

In 1929, purchases by the Federal government accounted for only 2% of GDP, half of which was spent on national defense, and by 2000 this share had grown to around 7.5% of GDP. Total current spending by the Federal government grew much faster, from 2.5% of GDP in 1929 to 19% of GDP in 2000. Together with state and local governments, total government spending rose to almost a third of GDP, and many voters assume the trajectory of government spending is ever upwards.

The perception of continuously increasing government spending is not entirely accurate, however, as Figure 1 helps to illustrate. The role of the federal government grew significantly during the Roosevelt Administration, first as a result of the its efforts to deal with the effects of the Great Depression, and then from the rapid military spending of the Second World War. Once the postwar economy stabilized, however, the federal government's share of the economy grew much more slowly. In a paper prepared for the Joint Economic Committee, Gwartney, et al. (1998) noted that between 1960 and 1996, government grew more slowly in the United States than in any other developed nation (i.e., the member states of the Organization for Economic Cooperation and Development). Of these developed countries in 1996, the United States also had the smallest relative size of the combined federal, state, and local governments.

**Figure 1: Federal Government's Share of the Economy**



In relative terms, the size of the federal government has certainly been higher than at the end of the Clinton Administration. In 1975, federal expenditures peaked at 21% of GDP, and then fell during the Carter years. Federal spending peaked twice at 23%, first during the Reagan Administration's military buildup and next during the first Bush Administration. Overall, federal expenditures increased as a share of GDP by an average of 0.2% per year between 1949 and 1975, but between 1975 and 2000 this share *declined* by an average of 0.1% per year. The federal government also employed less of the labor force. After 1955, federal employment rose more slowly than the overall labor force, falling from 4.3% of the

labor force to 2.8% in 1990. During the Clinton Administration, the number of federal workers actually declined, and as a share of the labor force it fell to 2.1% by 2000. At the same time, state and local government spending stabilized after 1975 to between 10-11% of GDP, while the state and local government's share of the labor force slowly declined.

How do the political parties compare on the growth of federal expenditures? During the Clinton Administration, federal spending fell from 23% of GDP to 19%, while during the first five years of the current Bush Administration, the share of federal spending rose by 1.5%. For the entire postwar period, as Table 6 shows, federal expenditures were higher on average under Republicans, and the difference was statistically significant. As a share of GDP, federal expenditures rose by an average of 0.3% per four-year term. Federal expenditures grew slightly faster during Republican administrations, but the difference was not statistically significant.

	<b>Democrats</b>	<b>Republicans</b>	<b>t-Statistic</b>
<b>Current Federal Expenditures</b>			
Average share of GDP	18.7%	19.9%	3.94*
Average four-year change in GDP share	+0.3%	+0.3%	0.20

Republicans may nonetheless object to the conclusion that the size of government has not increased more under Democratic administrations, since Democrats (Roosevelt and Johnson) are responsible for the creation of both Social Security and Medicare, two of the largest components of federal spending, along with national defense spending and interest on the national debt. It is difficult to find objective measurements of these future obligations for comparison, but the argument is valid, even if the partisan comparison has been weakened by the recent unpaid expansion of Medicare drug benefits. Clearly, these current expenditures, like interest on the national debt, are not discretionary. Both Social Security and Medicare are programs created by Democrats that carry an implicit future debt, and though these programs were designed to be self-sustaining, higher life expectancies, rising medical costs, and slowing birthrates have made them harder to sustain under current projections. But to the extent that society wants these popular programs, government needs to figure out how to pay for them, and to be fiscally responsible we must either increase contributions, reduce benefits, or increase government savings to prepare for the future.

### **Does bigger government lead to slower growth?**

Underlying the concern over the size of the government's share of the economy is the belief that a larger role for government reduces economic growth. Most economists would agree with this argument if it represents an extreme form of government which dominates all aspects of economic affairs. In this scenario, the private incentive is quashed, productivity is stagnant, incomes are low, and growth is fueled only by high rates of investment through forced savings. But does such a description actually apply to the United States?

Barro (1990) has made a persuasive case that the relationship between the size of government and economic growth is shaped like an inverted-U, with low growth resulting from both too little and too much government. That is, both too little government and too much government lead to slower rates of economic growth, but there is optimal size of government that is not zero. Gwartney, et al. (1998) agreed, though they considered the size of government in the first half of the 1960s to be the optimal level and argued that income would have been 20% higher in 1996 had government stayed the same relative size.

Is the United States on the downward-sloping side of the inverted U? That is, is the marginal effect of growth in government bad for economic growth? For the economies of western Europe, most economists would agree that the marginal effect of government on growth is clearly negative, but the evidence is weaker that this is also true for the United States. Gwartney, et al., for example, chose to make their case using the period 1960-65 as their growth baseline, a half-decade with the highest growth rates in postwar American history and, until the Kennedy tax cuts went into effect in 1964, a period characterized by a maximum marginal tax rate of 91% on unearned income. They then compared this to the period 1990-95, a half-decade which began with a recession, to argue that growth in government reduced economic growth. Yet even as they wrote their paper in 1998, the economy was beginning to once again grow at a rapid pace. Their comparison was thus not fairly representative, and their estimates need to be taken with a grain of salt.

In considering the historical experience for the U.S., using data provided by Maddison (2003) and summarized in Table 7, I find that the average growth of real GDP did decline over time, which lends credence to the argument that the rising size of government after FDR slowed economic growth. But population growth rates were higher before the Second World War, and in fact the average real growth rate *per capita* was faster after 1950, when the government was significantly larger. Furthermore, the standard deviation of growth was smaller, suggesting that the growth of government was not only correlated with faster growth, it was also correlated with more economic stability.

	<b>Time Period</b>	<b>Real GDP Growth</b>	<b>Standard Deviation</b>	<b>Real GDP Per Capita</b>
	1820 – 1870	4.0%	5.3%	1.3%
	1870 – 1910	3.8%	4.5%	1.8%
	1910 – 1950	3.4%	7.7%	1.7%
	1950 – 2000	3.5%	2.3%	2.2%

Certainly there are many ways in which government can reduce economic growth. Private business is usually much better than government at providing incentives to work harder and smarter, and a good government must recognize and rely on it. Unless they are used to discourage inefficient behavior, taxes and subsidies can distort private incentives, and government spending can crowd out the private sector. Free markets work very well much of the time, as long as private firms are competitive, buyers and sellers have enough information about what they are buying so neither is taken advantage of, and third parties are not affected. But these conditions are not always met by private markets without government oversight, and there are many types of “public” goods that private markets cannot provide efficiently, if at all. These public goods may include such things as transportation infrastructure, social insurance, financial regulation, basic scientific research, and education, and even perfect markets do not necessarily result in a fair distribution of income. Government can help create a stable climate for private investment in which people trust that their investments will be protected and have faith that the future will be brighter. Certainly government could often perform some of these functions better, but if less government was always good for the economy, then Somalia would be one of the world’s wealthiest countries instead of one of its poorest.

### **Is it accurate to characterize Democrats as the “tax and spend” party?**

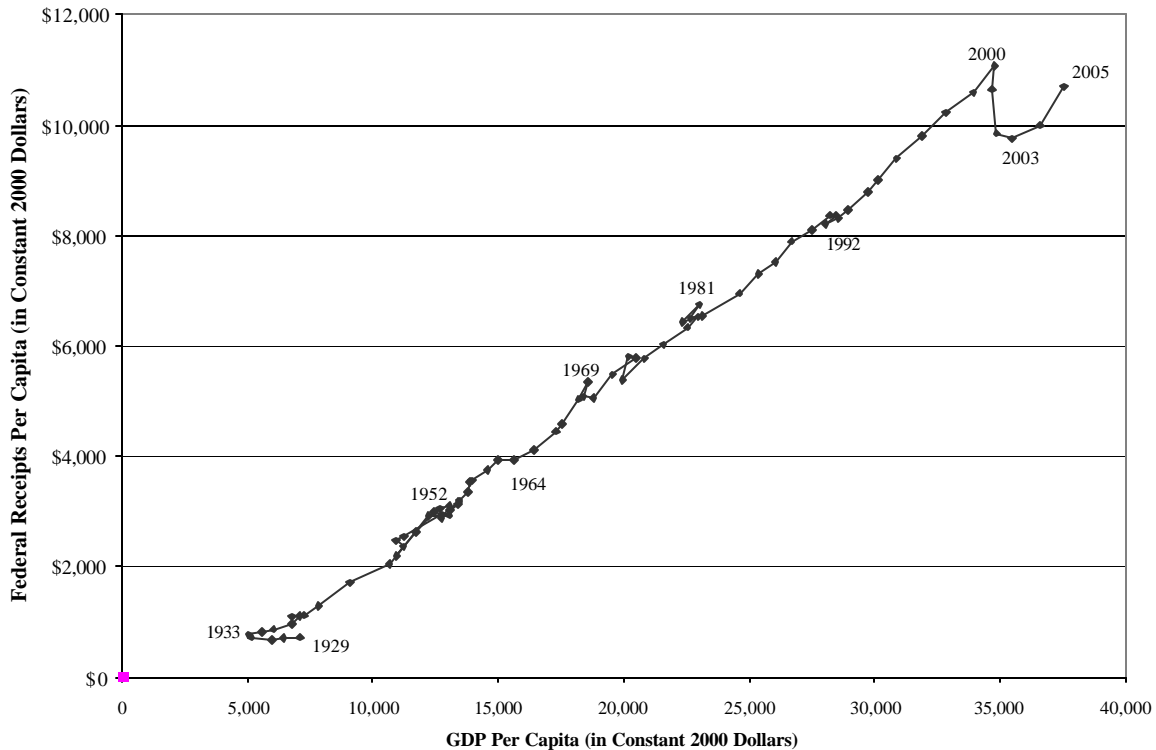
While current federal expenditures did not grow faster under Democrats, the data do show that current federal receipts have grown significantly faster under Democrats. In Table 8, federal receipts are shown to be higher under Democratic administrations, and as a share of GDP they increase, on average, under Democrats and decrease under Republicans. These differences are statistically significant.

Is there a good explanation for the increase in tax receipts under Democrats? While Republicans would offer their own interpretation, one could easily argue that Democrats have behaved with more fiscal responsibility. The average federal budget deficit has been significantly larger under Republicans, and smaller under Democrats. Looking at rate of changes, the deficit tended to expand under Republicans and shrink under Democrats. Indeed, it is well known that the Clinton Administration's first major act was to increase taxes on the wealthiest Americans to help balance the budget, a tax increase that passed the Senate by a 51-50 vote and left many Republicans warning that an economic collapse would follow.

Table 8				
Average Growth in Federal Receipts, 1949-2005				
		Democrats	Republicans	t-Statistic
<b>Current Federal Receipts:</b>				
	Average share of GDP	18.3%	18.0%	-2.40*
	Average four-year change in GDP share	+1.4%	-0.9%	-2.20*
<b>Federal Budget Deficit :</b>				
	Average share of GDP	0.4%	1.8%	5.76*
	Average four-year change in GDP share	-0.9%	+1.2%	1.56

However, an even better explanation is that tax receipts rise with growth, and Democratic administrations have tended to preside over faster growth. Figure 2 shows the relationship between federal receipts and GDP since 1929, adjusting for inflation and population growth. For the most part, the relationship between the two appears to be almost constant, with an estimated elasticity significantly greater than one. Not only do tax receipts rise with GDP growth, but real tax receipts per capita rise at a faster rate than real GDP per capita.

**Figure 2: The Relationship between Income and Taxes**



Before the current administration, there are only a few anomalies in the relationship between tax receipts and GDP: between 1929 and 1933, GDP fell without a corresponding fall in receipts; in 1964, the

Kennedy tax cuts stimulated growth without increasing real receipts per capita; and in 1969 and again in 1981, receipts appeared to be relatively high compared to the trend. But by far the largest anomaly is the fall in receipts that resulted from the current Bush administration's tax cuts. Federal receipts as a share of GDP fell by 3.1% during President Bush's first term, the largest such drop in history. As the economy has begun to recover, federal receipts have begun to rise, but the resulting shortfall by 2005 was over \$2000 per capita, in current dollars, or \$600 billion in foregone federal receipts for 2005 alone.

Since the Reagan administration, economists have argued that there is a correlation between the federal budget deficit and the trade deficit that is in part causal. The federal budget deficit reduces overall domestic savings, and when domestic saving is less than gross private investment – whether because private saving is low and investment is high, or the government deficit is high – then foreign savings must make up for the difference. If foreigners are lending us money, whether by buying our government securities or other domestic assets, then they are not buying our exports with the dollars they earn from our imports. As with the budget deficit, the average trade deficit under Democratic administrations was 0.4% of GDP, and the average amount under Republicans before the current administration is only slightly higher at 0.6%, though the difference is statistically significant. Currently under President Bush, however, the average trade deficit has been 4.7% of GDP and continues to rise. As a government and as a country, we are borrowing from future generations. If Democrats are the “tax and spend” party, then Republicans have become the “borrow and spend more” party.

## Summary and Conclusion

In this paper I questioned several aspects of the common assertion that Republicans are more competent at economic management. Using standard government statistics, I consider (1) whether the economy grows faster when Republicans are in charge, (2) whether the size of the government keep expanding, especially under Democrats, (3) whether bigger government leads to slower growth, and (4) whether Democrats are really the “tax and spend” party.

The results indicate that by a wide variety of measures over the past fifty years, the economy has not performed better under Republicans, but instead has grown faster under Democrats. In the last fifty years the government has not grown very fast relative to the rest of the economy, and since the peaks of 1975, 1983, and 1992, the relative size of the federal government has actually declined (though it has risen again under the current administration). Overall, the size of government did not grow faster under Democrats than under Republicans. Although governments in other nations that play a comparatively larger economic role in their economies may cause slower economic growth, it is not clear that the U.S. government is sufficiently large relative to the economy to reduce the American economic growth rate. Finally, it does appear that taxes have risen significantly more under Democrats, but most of this can be explained simply by the fact that the economy has grown faster under Democrats. Democrats have tended to run smaller budget deficits, and this in turn means the economy tended to have smaller foreign trade deficits.

If the economy has performed better under Democrats, what accounts for this difference? There are many possible hypotheses for this, including good (and, for Republicans, bad) luck, or a lagged effect which reduces, but does not reverse, the significance of the difference. Certainly there are limits to how much political leadership can affect the performance of the economy. But to the extent that Democrats have presided over a faster-growing economy and have affected economic growth, I suggest a political attitude as much as any particular set of policies. Republicans are more likely to be economic fundamentalists who believe that government *is* the problem, and therefore see little reason to craft intelligent solutions to economic problems since government's real objective should be to just get out of the way. With such a coherent ideology, solutions are simple and easy to explain to voters, even when they are wrong. Democrats are more likely to believe that government, at least if it is *competent*, can actually fix many problems. Because they tend to believe that problems are complex, Democrats are more likely to heed expert advice. While this attitude may be harder to explain to voters, it usually leads to better policies.

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## Notes

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<sup>1</sup> When growth rates are highly variable, their averages can be significantly overstated. An index that rises from 100 to 125 in one year, only to decline back to 100 in the following year, would have growth rates of 25% and -20% respectively, an average of +2.5% even though there was no net change in the index. Using natural logarithms, growth rates in this example would be +22.3% and -22.3%, an average of zero.

<sup>2</sup> Using quarterly data from the BEA and monthly data from the BLS (except for multifactor productivity and weekly earnings, which are only available annually), I used the simple ordinary least squares method of regression analysis to see if these data were significantly correlated with Republican administrations. To represent Republican administrations I used a so-called "dummy" variable, which equals one in years with Republican administrations and zero otherwise. For example, the dummy variable is zero for the fourth quarter of 2000, and one for the first quarter of 2001.

<sup>3</sup> To estimate these lagged effects, I estimated a series of 17 regressions of the real GDP growth rate on a succession of lagged Republican "dummy" variables. While there are more sophisticated methods to estimate the lagged effects of government policy on growth, along with resulting changes in growth trends, these methods are best left to later research. With even just this simple lag structure, we cannot reject the hypothesis that the economy does not grow faster under Republican administrations with any reasonable lag.