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Kerry economically scary?

By Richard W. Rahn
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Why do some economies grow while others do not? Economic growth has preoccupied many economists for the last two centuries. Fortunately, we now largely know which policies foster economic growth and which do not.

Unfortunately, there remains much economic know-nothingism in the political and media classes, producing statements that such-and-such a policy will create growth when, in fact, it will do the opposite.

To understand what will really create economic growth, let's start with the basics. Growth occurs when productive capital investment increases (that is, new and better plant and machinery, including computers and information systems); the amount and quality of labor increases; and innovations or policies reduce costs. Traditional studies for the U.S. economy roughly showed incremental capital investment accounted for 0.75 percent of growth yearly, and incremental labor accounted for a similar amount, while real cost reduction (innovation and productivity) accounted for 1.5 percent yearly, for an average total growth rate of about 3 percent yearly.

One of the world's most highly regarded economists is Professor Arnold Harberger, who has spent a long and productive life studying factors that affect economic growth and advising governments. In a paper, he delivered Aug. 15 to the Mont Pelerin Society, Mr. Harberger argues that, given economic history, "it is a cause for rejoicing when a [developed] country manages a growth rate of 3 to 4 percent per annum in real terms." The U.S. has managed this feat during the last quarter-century. The Reagan reforms sparked a spectacular burst of growth exceeding a 4 percent average in the last seven years of his presidency. In the mid-1990s, we again had more than 4 percent growth, and again over the last couple of years.

Mr. Harberger argues the movement toward freer trade has had a noticeable and measurable positive impact on not only U.S., but also world economic growth. Trade liberalization reduces the real costs of raw materials, components and final products, thus increasing economic well-being. When trade is liberalized, it produces a bump in economic growth, but does not affect the continued rate of growth unless there is another reduction in trade barriers. However, even a one-time reduction in trade barriers continues having a positive impact because, even though the economic growth may be constant, it is now measured from a permanent higher level, leaving everyone better off.

Critics of freer trade point to the costs of lost workers in some specific factory, and it is indeed true that those factory workers who lose their jobs at least temporarily are worse off, but all those who consume the lower-priced products are better off -- and there are many times more consumers than producers of any good. Try to picture a world where there are no Wal-Marts or Home Depots, where there are just small mom-and-pop high-cost stores selling only domestic merchandise -- that is the world of 50 years ago, 1954. Few Americans could afford air-conditioners and dish washers. Black and white TVs were expensive and unreliable.

The average American now has a home 50 percent bigger than the homes of a half-century ago, with multiple bathrooms, color TVs and other appliances that did not exist, along with much better and safer automobiles. The increases in productivity and trade liberalization have not produced the job losses and wage reductions critics predicted. Real jobs and much higher real wages have grown much faster than our population over the last half-century, which is why a much a higher percentage of our population now has jobs than 50 years ago. The average job not only pays far more, after adjusting for inflation, but the work environments for most people are far superior. Working in an air-conditioned office or nice store sure beats working in a overly hot or overly cold and grimy factory.

Those politicians who propose policies that would restrict trade, increase taxes on capital and/or labor; and increase costly regulations on labor and business are in effect proposing policies to reduce economic and job growth. Unfortunately, Mr. Kerry proposes to do all of the above. He wants to put restrictions on both current and future trade agreements -- and each one of these would cause a one-time drop in baseline economic growth and a permanently reduced economic level.

His proposals to "tax the rich" would in fact increase taxes on capital -- i.e., capital gains, dividends and savings, all of which will reduce the capital stock. (He has argued that the negatives of his tax increase proposals will be offset by a drop in the deficit, but his new spending proposals exceed many times any possible revenue increase from his tax package.) Also, his proposals to raise the minimum wage and impose other restrictions on worker employment will only reduce jobs and real wages.

Such policies are not compassionate but in fact are hurtful. Either Mr. Kerry does not or chooses not to understand economic reality.

Both Mr. Kerry and President Bush should propose major and specific cuts in other government spending and regulatory costs to offset the rise in oil prices and increases in homeland security costs if they desire to keep the economy growing. The American people deserve more than wishful thinking and silly rhetoric from their leaders.

Richard W. Rahn is a senior fellow of the Discovery Institute and an adjunct scholar of the Cato Institute.

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