The Washington Times
www.washingtontimes.com

Feeding the kitty for Katrina

By Richard W. Rahn
Published September 21, 2005

Assume you were a regular blood donor but had an accident in which you lost a considerable amount of blood. Do you think you should increase or decrease the size and frequency of your blood donations until you recover?

Though most politicians are smart enough to answer, "decrease the blood donations," many seem not smart enough to understand that, when you take an economic hit, you don't want to unnecessarily add burdens to the economy. I refer to the call from some politicians to increase taxes or not extend President Bush's tax cuts to "pay" for New Orleans. (Note: Not making the tax cuts permanent is the same as a tax increase because tax rates therefore would be higher than now.)

The tax increase proponents seemingly cannot grasp that taxes reduce our economic vitality. When taxes rise, the economy slows. When taxes are reduced, job creation and economic growth accelerate. Those who do not understand the role of incentives are always surprised when tax revenues increase, as they did after the Reagan and recent Bush tax cuts, and fall or stagnate when tax rates increase. (For instance, the capital gains tax now -- at a maximum 15 percent -- produces many times the tax revenue it did when the rate was 40 percent, even after adjusting for inflation and the economy's size.)

Raising tax rates can increase government revenue over the long run, if the rate is low enough to only have a minimal effect on incentives to work, save and invest. Unfortunately, almost all major U.S. taxes are at rates where the disincentive effects of any rate increase eventually swamp any short-term revenue gains. Almost any tax rate increase can augment revenues in the very short run (the next week or month), before people and businesses have time to adjust their behavior, which most often result in lower long-term tax revenue.

Given it would be foolish to raise tax rates, and given the government will spend several hundred billion dollars (advisably or not), and the private sector probably much more, how should recovery from Katrina be paid for?

Before answering, we need to understand the real problem. The economy lost many productive assets -- factories, stores, bridges, schools, etc. These assets need to be replaced, along with the workers' homes to give us the same potential GDP as the economy had before the storm.

To minimize the burden, we should begin by looking at where resources are now wasted in our economy. If we cut waste by the amount we need to replace what was lost, there would be no net loss to the economy either in jobs or productive assets.

The Competitive Enterprise Institute's "Annual Snapshot of the Federal Regulatory State" says the economy's estimated total regulatory burden last year was $913 billion -- a little more than $3,000 for every man, woman and child in the U.S.

From numerous microeconomic studies we know a large percentage of all regulations are unduly burdensome or unneeded. If the president, and state and local officials, insisted every department of government at every level do a sound cost-benefit test of every regulation, with the goal of reducing the regulatory burden at least one-third in the next year, that would do much to offset Katrina's economic burden.

There are already many rules, orders and laws requiring cost-benefit analyses for regulations, but these are not taken seriously by the bureaucrats and rarely enforced (the Treasury Department is a particularly notorious example).

The president should demand an end to regulatory arrogance and insist every agency chief be held accountable for performance. Congress also must get serious about regulatory costs and stop passing a never-ending stream of dubious and often counterproductive regulatory requirements.

Nearly every adult in America who has had an encounter with almost any level of government knows wasteful spending is colossal, despite politicians' eternal whining they haven't enough money. As long as governments can take an ever-increasing portion of the economic pie, this will never change.

Many studies have clearly shown the federal government, and many state and local governments, are well above the size at which the good they can do is maximized.

The president should insist Congress create a rigorous and enforceable mechanism for reducing the size of government, over time, to something closer to the optimum. This will force the debate to change from how much we spend to how we spend money allocated to the government sector.

The landslide re-election of Japan's Prime Minister Junichiro Koizumi, on a platform of radical economic restructuring, shows people will accept major change in government operations, when they believe it is necessary and the leader serious.

The Katrina tragedy, ironically, has given President Bush and congressional leaders the opportunity to make necessary radical changes, if they have the courage.

Richard W. Rahn is director general of the Center for Global Economic Growth, a project of the FreedomWorks Foundation.