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Lethal ignorance

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If you really like apple pie, and you could have one-third of a 2 pound pie or half of a 1 pound pie, which would you choose? This grade school math problem is very similar to the problem politicians and economic policymakers face in deciding whether to distribute smaller pieces of a bigger pie, or vice versa. Their decisions tell us much about their real motives.

Those who believe government can do "good" by maximizing its expenditures on health, education, welfare and income redistribution, should be the most concerned that our government tax and regulatory burden does not become so excessive it begins to kill the golden goose.

Virtually all studies of the optimum size of government show the tax and regulatory burdens in most countries are well above the optimum for the long run maximization of social welfare and economic growth.

As we all know, politicians like to spend other peoples' money and then take credit for the expenditure, but not necessarily for the taxes and borrowing that finance the outlay.

Many U.S. politicians on the left advocate the "European Model" whereby the government taxes and regulates more. Some in Europe advocate following the so-called "Anglo-Saxon" model of lower tax rates and fewer regulations.

Assume you were a politician with a long-run view (though this may be an oxymoron) who wanted to be able to spend the most money for "beneficial" programs (in real dollars) over a 20 years. And though you are a big spender, you realize higher tax rates slow economic growth and that a smaller pie could result in less revenue. What should you do?

Answer: Look at the data and the theories:

Last year the governments of the United States, Germany, France and Italy each spent a little less than $15,000 for each of their citizens (as measured on the basis of current-dollar purchasing-power parity). Each country financed government spending through a combination of taxes, fees and borrowing. (The deficits as a percent of gross domestic product (GDP) were: France 3.2, Germany 3.9, Italy 4.3, and the U.S. at 3.7.)

The politicians on each side of the Atlantic took very different approaches to achieve the same spending (and deficit) result. In the 1970s, '80s, and '90s, the Europeans greatly enlarged their government sectors relative to the U.S.

Up to the early 1980s, European countries were growing faster than the U.S., but as expected their economic growth slowed sharply as taxes increased. In 1980, citizens of France, Germany and Italy had about 80 percent of the real purchasing power of their American cousins, but that has now fallen to about 70 percent. If present trends continue, with the American economy growing on average 2 percent faster per year than France, Germany and Italy, the average American will have twice the real purchasing power of his or her counterpart in France, Germany, and Italy in 20 years.

Assuming the European governments continue to spend 51 percent of their GDP and grow at the same rate as they have for the last few years, in 2025, they will spend approximately $22,000 per citizen (in today's dollars).

If the American economy continues growing 2 percent faster yearly than the Europeans, and if the U.S. government continues spending 36 percent of gross national product, actual government expenditures would average about $31,000 per person (or double that of today).

To obtain a better understanding of the economic effects of taxation, the Treasury Department just announced it will do "dynamic analysis" of proposed tax changes (it will look at how tax rate changes affect incentives to work, save and invest).

Dynamic analysis (and dynamic tax revenue scoring) is long overdue. Over the years, most opposition to "dynamic" analysis and scoring has come from people who should most benefit from better data. For instance, even though the Treasury announcement was almost universally applauded by respectable economists, an economist from a left-wing policy organization (the Center on Budget and Policy Priorities) called the Treasury proposal "unnecessary and unwise." He also said he couldn't think of any fundamental changes that could improve revenue estimating, though many estimates have been grossly off.

The suicidal ignorance of European politicians and their American philosophical comrades is now so blatantly obvious one can only wonder if their agenda is really to reduce economic poverty as claimed or if their real agenda is to maintain power and the ability to distribute goodies from the government, rather than diminish economic dependence and misery. Otherwise, why would they be so resistant to obtaining better economic data and analysis?

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