The Washington Times
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Growing the Economy for Dummies

By Richard W. Rahn
Published August 31, 2011

New books put answers right at our policymakers' fingertips

Did you know that in Denmark, the poorest 30 percent pay 14.1 percent of all taxes and the richest pay 48.7 percent, while in the United States, the poorest 30 percent pay just 6.1 percent of all taxes and the richest 30 percent pay a whopping 65.3 percent? The surprising thing is not that the richest pay most of the taxes but that the U.S. has nearly the most progressive tax system in the world, while the Scandinavian countries have about the least progressive tax systems, contrary to commonly held belief.

The above facts, along with hundreds of other useful tidbits, are found in a compelling new book, "Government Versus Markets: The Changing Economic Role of the State" (Cambridge University Press, 2011), by Vito Tanzi. Mr. Tanzi is one of the world's most highly regarded economists, and for good reason. As a senior economic official of the International Monetary Fund for two decades, an undersecretary for economics and finance in the Italian government and author of 14 books, he does not let his biases get in the way of empirical evidence.

In his new book, Mr. Tanzi clearly shows how governments in most developed countries have grown over the past century. The many tables are a delight for us data hounds. Some advocates of higher taxes argue that tax rates on labor do not have much impact on the willingness to work, but Mr. Tanzi gives us a very clear chart plotting the tax rate on labor versus the number of hours worked per year in many countries. It shows that there is a strong inverse relationship between tax rates on labor and hours worked. Such facts are inconvenient for the big-government, high-tax crowd. Mr. Tanzi is far from being anti-government, but the facts and data he presents show how most governments have grown far beyond the optimum point, and he is a bit pessimistic about the ability of democracies to rein in excessive and destructive government.

Near the end of the book, Mr. Tanzi observes: "Once the population of a country (or, more often, groups within it) come to see the government as a potential cow that can be milked, there is no longer a limit to the demands for more public spending. There are literally infinite ‘needs’ of the population, and infinite groups capable of organizing politically, to press for more government spending or other government actions that would benefit them.”

But despite Mr. Tanzi’s pessimism, he documents how two countries, Sweden and Canada, have changed course and reduced the size of government because the body politic came to understand that the cow was being overmilked and soon would go dry or die.

By happenstance, Peter Ferrara has written “America’s Ticking Bankruptcy Bomb” (Broadside Books, 2011), which is almost a companion piece to Mr. Tanzi’s book. Where Mr. Tanzi primarily uses data to show the global growth of government spending, taxing and regulation, Mr. Ferrara gives us more of a historical narrative of how the United States got to this point. Mr. Ferrara served in President Reagan’s White House Office of Policy Development and, subsequently, in President George H.W. Bush’s Justice Department and has spent much of his life developing and proposing policies that would lead us back to economic sanity. His new book not only gives us the history of the various programs and how they contributed to the current debt crisis but also proposes solutions, including describing what other countries have done to deal successfully with similar problems.

Mr. Ferrara’s chapter on the retirement debt bomb clearly describes how the Social Security funding solution has been well-known to U.S. policymakers for 30 years, yet many politicians have preferred to demagogue the issue rather than solve the problem. Chile was the first nation in the Americas to adopt a traditional social security system, way back in 1925 - 10 years before the United States. By the late 1970s, however, the Chilean system was running out of money despite higher and higher taxes. The young labor minister, Jose Pinera, who has a doctorate in economics from Harvard, led a fundamental reform of the system from a government-defined benefit system to a private-account defined-contribution system, which is owned by the workers.

The Chilean system has been so successful during the past 30 years that it has been copied by more than 30 countries, including Sweden and Australia. Chileans retire with far more wealth than the average American, despite the fact that Chile is just a low-middle-income country. In both Chile and the United States, employers are required to set aside a little more than 12 percent for the pension program, but in Chile, someone with the same earnings as an American will be getting $55,000 as an annual pension, while the American, working the same number of years, just gets $18,000.

The fact, as Mr. Ferrara explains so well, is that we need not have miserable retirement and government medical systems that barely serve the needs of the people while driving the country into bankruptcy. What we need instead are programs in which individuals have control over their own retirement and medical accounts and have the flexibility to design them to meet their needs. Other countries have proved it can be done.

If every member of Congress and Washington policymaker would read the books by Mr. Tanzi and Mr. Ferrara and act upon their recommendations, our fiscal and entitlement mess would soon be part of a dark past.

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