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THREE BAD EXAMPLES

	United States	France	Cayman Islands
Total Govt. Spending, % of GDP, 2012	40.3%	55.9%	25.4%
Increase in Govt. Spending as % of GDP (2006-2011)	12.5%	5.5%	43.5%
Debt-to-GDP Ratio, 2012	74.0%	90.0%	24.9%

Sources: BEA, Congressional Budget Office, Eurostat, Cayman Government Economics and Statistics Office

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Stop Global Economic Malpractice

by Richard W. Rahn

GROWTH IN SPENDING REQUIRES CUTBACKS

Two centuries ago, it was common practice for the doctors to bleed a patient in the belief that it would get rid of the "vapors" that were thought to be causing the illness. As a result, most patients got worse and many died. Much of the world is now suffering from equally incompetent politicos playing economic doctors.

Most of the major democratic countries are headed for a fiscal cliff because they have been increasing government spending at a rate far higher than economic growth for the past several years. Only seven of the 38 largest middle- or high-income economies that are non-petroleum-state democracies that the Economist reports on each week can be said to have their fiscal houses in order (where economic growth is greater than annual deficits so that debt-to-gross domestic product ratios are not rising). The responsible seven are Australia, Chile, Mexico, Singapore, South Korea, Sweden and Switzerland. If you do not live in one of those countries, be prepared for rocky economic times ahead.

As families, businesses and even governments must eventually learn, when growth in spending exceeds growth in revenues, there will be a day of reckoning. Sometimes it is possible to increase revenues. People within a family might be able to take on extra jobs or work longer hours. Businesses might be able to increase sales. Sometimes, governments can increase tax revenues or fees. Usually, the most effective solution in all three cases is to cut spending or, at least, to cut the growth in spending.

Politicians tend to like bigger government because it gives them more power -- so they have a natural inclination to try to increase taxes rather than cut spending. The problem is the type of tax that does the least damage to economic growth and job creation is a tax on consumption that hits everyone. Politicians know the greatest chance of public approval for a tax increase is aiming at relatively few people and, particularly, people who can be characterized as evil -- such as "the rich."

As poster children for bad economic policy and for bad tax proposals, I have selected three rich jurisdictions: the largest being the United States; a large country, France; and a very small, largely self-governing overseas territory of the United Kingdom, the Cayman Islands. Despite the vast difference in size of these political entities, the three are exhibiting the same disease -- undisciplined spending. Each of their leaders is prescribing the very same lethal medicine -- tax increases on the most productive and on their capital.

Government spending as a percentage of GDP is rising rapidly in all three nations -- a trend that cannot continue indefinitely, as anyone who understands basic arithmetic can grasp. This problem can be solved only with an increase in economic growth and/or a reduction in spending. Tax-rate increases on labor and capital reduce economic growth. Even if a tax-rate increase managed to increase tax revenue, the underlying problem will only get worse as long as government spending is rising more rapidly than GDP growth. There is no rate of tax increase that can solve a problem of excessive spending.

President Obama of the United States, President Francois Hollande of France and Premier McKeeva Bush of the Cayman Islands each assume that their tax increase proposals will not significantly depress economic growth and job creation. They also assume that these upper-income and highly mobile taxpayers are going to sit still and pay more in taxes without taking either legal or illegal measures to avoid being financially plundered. Both of these "heroic" assumptions are contrary to history and theory. Putting off spending cuts will become even more difficult because of an increased demand for government assistance as economic growth gets even slower as a result of the tax increases.

The debt situation is even more serious than the accompanying chart indicates, not only for the three jurisdictions shown but also for most every other country. Unfunded liabilities for transfer payments are not included in these totals, and in most countries they dwarf the explicit debt many times over. Also countries such as the United States increasingly have made guarantees to banks and other financial institutions and to consumers for home mortgages, etc. The French also have liabilities and loans to various European Union entities and other institutions, which in total may equal their explicit debt. This is equivalent to an individual whose liabilities exceed his assets and who signs on to guarantee his neighbor's mortgage. To say that the global financial situation increasingly looks like a house of cards is a slur on a house of cards.

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