Aim Higher

By Richard W. Rahn

RAPID GROWTH IS POSSIBLE IF REGULATIONS ARE PRUNED

What changes in government policy should be made to achieve an annual average of 4 percent economic growth? That is the question President Trump and his team should be asking if they are serious about achieving a lower deficit while increasing spending on defense and the infrastructure. The Congressional Budget Office and many private economists are forecasting only a little over 2 percent growth (a bit higher than the recent past), and the president has said he hopes to achieve 3 percent — which is too little for the president to achieve his goals.

Is 4 percent growth per year achievable? An average of more than 4 percent growth was achieved during the last seven years of the Reagan administration and during the last term of the Clinton administration. Like now, in both cases, many in the economic and political establishment claimed that such growth rates were not possible. The U.S. economy grew 7.3 percent in 1984 alone (a rate unheard of for a developed economy), which no one had forecast, including those of us who were the Reagan "supply-siders."

Here is why 4 percent is possible and how to achieve it. As has been widely recognized, the United States has been suffering from a huge regulatory drag. Those responsible for producing all of the new regulations failed to do serious cost-benefit analyses and, hence, hundreds of thousands of regulations have been issued in which the costs far outweigh the benefits to the economy. The administration has already begun a rollback of the most destructive regulations, and a concerted effort to get rid of all of the counterproductive ones might add as much as 1 percent to economic growth.

Economic growth comes about from capital formation — the use of more and better tools, and more and higher-skilled labor. The labor force participation rate is at a three-decade low, indicating that, with the right incentives, there are many millions who might re-enter the work force. There are endless true stories about the mismatch between the skills that employers need and what people are trained to do. Too many young people are pushed into college where they take many useless courses — making them, in some cases, less employable — rather than obtaining a tech education or entering apprenticeship programs for which the Swiss and Germans excel.

The U.S. tax system has undermined capital formation by taxing productive savings and investment several times at high rates. The proposals to greatly reduce the corporate tax rate and to expense investment (an immediate write-off) will do much to make the United States internationally competitive again. These tax changes, along with a large reduction in individual tax rates that are above the long-run revenue and growth maximizing rates, will spur growth. The House Republicans have proposed a controversial border adjustment tax to fill a projected revenue hole from the tax rate reductions. It may be illegal under the World Trade Organization rules, and would be unnecessary if greater spending cuts were made.

It has been reported that some agencies are targeted for as much as a 20 percent budget reduction. This should be the minimum start for almost all agencies. Anyone who has ever spent time around government knows that much of what is done is not necessary and often inefficiently performed. (The United States did perfectly well with a much smaller government in the past, and other jurisdictions — e.g., Singapore, Hong Kong, Switzerland — have shown that it is possible to achieve higher real incomes and a higher level of human development with smaller government.)

If someone from the Environmental Protection Agency who has been writing industry-destroying regulations is suddenly freed (by the elimination of their job) to do something productive in the tax-paying private sector rather than the tax-spending government sector, it is a win-win for the American economy. If a bureaucrat at the Agriculture Department who dishes out corn subsidies is suddenly freed from this wealth-destroying activity and given the opportunity to concentrate on how to produce more, better and less expensive food in the private sector — it is again a win-win for the American economy. Congress needs to stop funding international organizations like the Organization for Economic Cooperation and Development that use taxpayer dollars to lobby for growth-destroying, higher taxes and regulations. And finally, Congress needs to become serious about reducing the growth in the pension and medical entitlements that account for more than 50 percent of the budget.

Some have argued that U.S. economic growth is limited by the lack of new investment opportunities. They are trapped in a mindset in which they treat variables as constants. They fail to see how new technologies have the potential to train workers to be far more productive. None of us knows where the next wealth-creating products like the internet and the iPhone will come from, but it is almost certain that they will come.

The Republicans are in danger of falling into the old trap again, by insisting that the tax cuts be revenue-neutral, without fully adjusting projections for the new tax revenue stemming from a larger, high-growth economy. The lesson is this: Aim high and then put in the policies necessary to hit the new target.

Richard W. Rahn is chairman of Improbable Success Productions and on the board of the American Council for Capital Formation

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