O N T H E D R Y S I D E

No.SIXTY-FIVE

John Hyde

Published
10-7-84

TAXES AND ECONOMIC GROWTH

Whatever the evidence available to the national leadership, democratic governments don't adopt even the best policies against the firmly held wishes of the electorate. If Australian and British attitudes are similar, then two studies I have come across present us with a bit of a dilemma. One says very clearly that Britishers want the welfare state and are prepared to pay even higher taxes to have it. The other says, just as clearly, that high taxes are hostile to economic growth and hence to high living standards. Further, the second study provides evidence that those who lose most when growth is poor are those who have least.

The survey of British opinion was done by the London based firm Marplan; and the study of national growth and tax was adapted from the World Bank Staff Working Paper No.605 by an officer of the Bank, Mr. Keith Marsden. I suspect that one or other of the findings will surprise many people but both accord with my experience as a politician. I am however very surprised by the unequivocal extent of the evidence.

The Marplan survey shows 49% of Brits believe that government services, such as health, education and welfare should be extended even if it means some increase in taxes, while only 23% think taxes should be cut, even if it means some reduction in government services. The remaining 28% think things should stay as they are, or else have no opinion. This has to be interpreted as a massive endorsement of Beveridge style socialism.

One might be tempted to suspect that the survey drew on a biased sample, but the same sample blew a mighty raspberry at the trade union movement. Only 4% thought employers should be squeezed for all they were worth, only 9% of workers interviewed thought their wages should increase in purchasing power even if the economy was not growing, and only 14% said that wages should keep pace with inflation, even if the economy was contracting. Eighty-nine percent said productivity was at least somewhat important to living standards, and seventy-three percent said very important.

The British see a clear link between productivity and living standards but apparently a large majority of them see no link between high taxes and low productivity. If they did, what then would be their attitude to the welfare state ?

Over the ten years 1970-79, the World Bank study compared twenty countries: Brazil, Cameroon, Chile, Jamaica, Japan, South Korea, Liberia, Malawi, Mauritius, New Zealand, Paraguay, Peru, Singapore, Spain, Sweden, Thailand, United Kingdom, Uruguay, Zaire and Zambia. These were grouped in ten pairs of similar per capita incomes but differing tax policies. Without even one exception the countries which imposed the lower tax burdens achieved the higher economic growth.
The margin between the averaged growth rates of the ten low tax countries and the high tax countries is truly staggering: - 7.3% compared with 1.1%. In ten years a gross product increasing at 7.3% per year and compounding, doubles, whereas one increasing at 1.1% adds only 12%.

Not only did private consumption grow more rapidly in the low tax countries, but with one exception, so did public expenditure on such services as defense, health and education. This additional public expenditure was financed not by high tax rates but by the rapidly expanding economies which yielded more taxes from bigger tax bases.
Life expectancy rose in all the surveyed countries but rose 8 years in the low tax countries and 6.2 years in the high tax countries. Life expectancy improved most in the poorest nations where more people suffer poor diets, poor sanitation, and poor health services, lending circumstantial evidence to an interpretation that high growth, and hence low tax is of greatest benefit to poor people.
It would be surprising if even those people with least economic and political clout could not have gained more from a doubling economy than from a mere twelve percent growth.

The workforce grew faster than production in the high taxed countries. Consequently productivity declined by 0.1% per year. This compared with an improvement of 5.0% for the low tax group.

65-3

It may take many years for investors, workers, entrepreneurs and consumers to respond to lower taxes, and Marsden cautions against seeing tax cuts as a quick fix for ailing economies. His sample of nations had experienced their respective tax regimes for many years, and the data reflected the consequences of tax policies over a longer time than the study.

Since the borrowing which finances deficits must be serviced, deficits are not a magic way of enjoying low taxes and the welfare state.

It may be difficult to convince the electorate that the cost of the welfare state is doing so much damage that it will pay them to forgo some popular welfare now, in order to enjoy better living standards in ten years time. Even so I don't think that an electorate which sees clearly the connection between productivity and earnings will refuse to accept cuts, so long as the cuts seem fair and reasonable, and so long as the elector retains a large measure of the security which the present system affords him. Needs based welfare, education and health systems could offer electors a safety net and lower taxation.

The Hawke Government has taken a step towards a needs approach by means testing the old age pension, and a step away from it by compelling the wealthy to enjoy the dubious benefits of Medicare. If it really wants to set our economy on a long term growth trend,it will forget about policies which increase government expenditure and taxation to provide benefits for people who can afford to look after themselves.

The World Bank study also looked at the links particular taxes have to investment, employment and productivity. Not all taxes were equally bad. Three taxes had particularly nasty consequences; corporate taxes stifled investment, tariffs wasted investment in unproductive activity and income taxes encouraged investment in untaxed housing at the expense of productive equipment. Perhaps something can be gained from a better mix of taxes.

However, the most important task is to explain to voters the high future cost of present government expenditure and to knock the idea on the head that high government expenditure is the most effective way of eliminating poverty.