World Bank Report Shows Big Government Reduces Economic Growth

A new report published by the World Bank has come to a spellbinding conclusion: High government spending and large public sectors substantially diminish economic growth. In fact, a slew of establishment economists and organizations have come to a similar conclusion. Daniel J. Mitchell (left), senior fellow at the Cato Institute, explained in a recent article that the era of socialism is over, and the field of economics is migrating toward a more laissez-faire ideology, where governmental authority is weakened and economies become more privatized.

In chapter seven of the World Bank's lengthy report, which chronicles the economies and governments of Europe, the following questions are posed:

- Are governments in Europe bigger than elsewhere?
- Is big government a drag on growth in Europe?
- How can governments be made more efficient?
- Should fiscal consolidation be a top policy priority in Europe?

"There are good reasons to suspect that big government is bad for growth," the report reads, and "[t]axation is perhaps the most obvious." Diminished economic growth is often triggered by the redistribution of wealth from the private sector to the public sector:

> Governments have to tax the private sector in order to spend, but taxes distort the allocation of resources in the economy. Producers and consumers change their behavior to reduce their tax payments. Hence certain activities that would have taken place without taxes, do not. Workers may work fewer hours, moderate their career plans, or show less interest in acquiring new skills. Enterprises may scale down production, reduce investments, or turn down opportunities to innovate. …

Over time, the authors add, socialistic governments create oppressive bureaucracies that stunt private-sector employment and establish a dependent public-sector system where the populace becomes wholly dependent on the state.

> The larger the group of people reliant on public wages or benefits, the stronger the political demand for public programs and the higher the excess burden of taxes. Slowing the economy, such a trend could increase the share of the population relying on government transfers, leading to a vicious cycle (Alesina and Wacziarg 1998). Large public administrations can also give rise to organized interest groups keener on exploiting their powers for their own benefit rather than facilitating a prosperous private sector (Olson 1982).

European governments are larger and more despotic than others, the authors explain, as they collectively spend about 10 percent of GDP more than other countries. In turn, over the last 15 years, "higher initial government size has led to slower economic growth." To be precise, in Europe, a 10-percent increase in the size of government curtails annual growth by 0.6-0.9 percent. These expanses in government often arrive through large government revenues that result in social transfers and wealth redistribution.

Beyond the World Bank's "startling" economic revelation, other establishment outfits are slowly beginning to grasp the idea of laissez-faire economics, as a new study conducted by economists at the European Central Bank (ECB) arrived at similar conclusions. As European politicians plead for the ECB to purchase risky debt from over-indulgent welfare nations such as Spain, Italy, Greece, and Portugal, ECB economists published a study showing the tumultuous economic impact of big government and high government spending.

The ECB study analyzed a diverse set of 108 nations — including both developed and emerging countries — spanning from 1970 to 2008. "Our results show a significant negative effect of the size of government on growth," the authors resolved. "Interestingly, government consumption is consistently detrimental to output growth irrespective of the country sample considered."

Mr. Mitchell notes that there are two important takeaways from the ECB's research: First, the data shows that big government is the agent to economic decline, which is evident regardless of whether the government's budget is financed by taxes or borrowing. The problem, Mitchell contends, is that so many policymakers fail to distinguish these two components, and "mistakenly focus on the symptom (deficits) rather than the underlying disease (big government)." Moreover, the Cato fellow asserts:

> The second key takeaway is that Europe's corrupt political elite is engaging in a classic case of Mitchell's Law, which is when one bad government policy is used to justify another bad government policy. In this case, they undermined prosperity by recklessly increasing the burden of government spending, and they're now using the resulting fiscal crisis as an excuse to promote inflationary monetary policy by the European Central Bank.

Further, Mitchell cites three other recent studies that transcribed likewise conclusions:

• A study by two Harvard economists found that "large adjustments in fiscal policy, if based on well-targeted spending cuts, have often led to expansions."

• The Organization for Economic Cooperation and Development noted in recent research that welfare programs are economically destructive because they lure people into dependency because "net disposable income would increase despite putting in fewer hours."

• A study from the International Monetary Fund concluded that "Cuts to pension and health entitlements had the most beneficial effect on economic growth."

"This is remarkable," Mitchell added. "It's beginning to look like the entire world has figured out that there's an inverse relationship between big government and economic performance."

The World Bank concluded that big government and high social transfers are the most prominent impediments to economic growth. "The regression results for Europe," the report avers, "show a consistently negative effect of social transfers on growth." This seemingly daunting revelation exemplifies precisely what is currently plaguing the U.S. economy, as President Obama's European-style socialism has drifted closer to the welfare-ridden, fiscal calamities which have come to define the nations of Greece, Portugal, and all the other indebted countries of Europe.