THE CENTURY FOUNDATION

COMMENTARY REDISCOVERING GOVERNMENT

Remembering the Purpose of Government

MARCH 23, 2016

The meme of national elections for a generation at least—back to the mid-1970s—has been unchanged. That meme, as I think I justifiably call it, is that small government is ideal.

Good economics and America's history, however, do not support the proposition. In fact, the best economic research of the past fifteen years in particular refutes it. And perhaps most important, America's achievements, and even its guarantees of personal freedom, are not the consequences of small government.

No matter. The meme is repeated by Republicans consistently in the current primary season, and in more subtle ways supported by Democrats. It of course reflects a deep American mythology about small government and low taxes that supposedly goes back to Thomas Jefferson (though he defied it often, not least to make the Louisiana Purchase). It is reinforced by a flow of books written by seemingly well-credentialed experts that claim small government is best—often based on the frailest of evidence.

Republicans have repeatedly returned to the meme in recent primary debates, as if the idea is biblical in proportion. Even seemingly reasonable Republicans such as John Kasich talk about how government programs are the last resort, and balancing the budget remains the Holy Grail. Donald Trump railed against the recent Obama budget for its size, though it is only 21.5 percent of GDP—about average for the past thirty-five years, and less than it was several times in Ronald Reagan's administration.

On the Democratic side, Hillary Clinton chastised Bernie Sanders because the size of government would be 40 percent greater under his plans. Sanders countered that he would raise taxes enough to pay for everything. Granted, a 40 percent increase would be substantial, but Clinton's point rested on government size alone, taking for granted that overall size would do damage, even if the programs reduced the size of private spending on health care, as Sanders proposes.

Why do these government officials seemingly distrust and too often stoke hatred for government? One of the principal claims of small-government advocates is that higher taxes reduce incentives to work and invest. Right-wing charges against the Bill Clinton tax increase of 1993 were based on just that. Income of top-tier earners did indeed decline in 1993, thus, they said, proving their point. The rich worked less hard, they claimed. But it turned out that the reduction in income of the top tier, who Clinton's plan taxed most, was actually the result of tax planning. Members of the top tier simply had moved income that they otherwise would have reported in 1993, to 1992.

A classic book on the consequences of higher tax rates was published by economists Joel Slemrod and Jon Bakija in 2000. Called *Taxing Ourselves,* it summarized the research done by themselves and other economists on higher tax rates and economic growth. It showed that higher tax rates did not retard economic growth, historically.

This fact should be apparent if you think about it for a moment. The federal income tax was created in 1913, and rates have only risen from that level since then. Yet over this period, the economy continued to grow. Indeed, the size of government grew significantly over the course of the twentieth century, but the rate of economic growth by and large remained the same. This relationship was true in Europe as well. Research about tax rates has gotten more complex, but nothing overthrows this central conclusion. To take a more extreme but still well-founded example, Nobelist Peter Diamond and economist Emmanuel Saez find that top tax rates of up to 70 percent would increase federal revenues, not repress work or investment. Moreover, the high rates, they argue, would not reduce economic growth, and might reduce inequality even before taxes. As an example, GDP per capita grew at an average rate of 1.68 percent between 1980 and 2010, when top-tier tax rates were low, while it was 2.23 percent when top-tier tax rates were more than 70 percent between 1950 and 1980.

Another now-classic book, *Growing Public,* by the economist Peter Lindert, published in 2003, provides additional evidence that the meme is wrong. Lindert analyzed the growth rates of a variety of rich nations, in Europe as well as the United States, and compared the rates to the size and growth rate of government spending. He found no relationship between the size of government or spending on social policies and economic growth rates.

A lot of government spending is simply necessary for growth. Education is an obvious example, as is infrastructure. The relationship is less obvious for other social programs, but they can also influence growth positively. For example, Lindert notes, generous paid family leave enables spouses to plan their careers, and invest in their skills, so that they can return to the job. In many countries, businesses are required to accept spouses who leave to raise children back into the corporation at the same job. Thus, spouses may work harder to develop their careers rather than believe they must give up work to raise children.

Americans seemed to have had little doubt about the purpose and importance of government throughout much of the twentieth century. In particular, faith in government seemed to rise with the early Progressive moment under Theodore Roosevelt and Woodrow Wilson, and then the New Deal of the 1930s, and again with the social programs sponsored by John F. Kennedy and Lyndon B. Johnson in the 1960s. As most of us know, these included Social Security, unemployment insurance, and financial regulations under FDR, and Medicare and Medicaid, as well as civil rights and anti-poverty legislation, under Johnson.

Faith in government, however, seemed almost to end with the rise of inflation and the poor performance of the economy in the 1970s and 1980s. We needn't go over the Milton Friedman years again—the famed economist succeeded in blaming inflation and simultaneous recessions on government spending. As a result of this and a few related factors, such as the frustration with, and tragic deaths of, the Vietnam War, surveys now show that, generally, Americans don't trust government to be efficient.

What is surprising is how entrenched blaming big government for a poorly performing economy has become. In truth, as suggested above, government was the cause of a strong economy through most of our history.

I myself published a book called *The Case for Big Government* in 2009 that reviewed the history of government's critical role in the economy and its importance as an agent of change. A particularly fine book, published in 2014, by Lane Kenworthy called *Social Democratic America* reviews the history of contemporary social policies and what can now be done to correct areas of social neglect. Kenworthy points out that, among many other things, Americans may in general be opposed to big government, but they support government spending in specific areas, such as education, Social Security, and even help for the poor. An influential book by Marianna Mazzucato, *Entreprenurial America,* published in 2013, shows incisively how important government investment in research and health has been to the business innovation often ascribed to venture capital and private business. Even Steve Jobs' major innovations, it turns out, were built upon research financed by governments in the United States and Europe. Kenworthy, Lindert, Bakija, and I have also produced a more academic book, due in the late spring, called *How Big Can Our Government Be?* It is based on the hope that facts—and good research—matter in this nation.

This spring, an important new book by political scientists Jacob Hacker and Paul Pierson, *American Amnesia,* will be published that is historically sweeping, articulate, and accessible. It is one of the best guides to how critical government has been to America's economic growth since its founding. The authors review government's part in the nation's improving health, which I found among the most interesting sections of the book. There is a great deal more, of course: infrastructure, Social Security, the Federal Reserve, the regulatory agencies, and anti-poverty policies.

America has now forgotten the true purposes and capabilities of government, it argues, and we have to revive that. Is it possible? Hacker and Pierson believe this is now America's vital task. They take on books and studies they disagree with, thankfully. They are concerned about an indolent media. They don't quite know what to do about a gridlocked Congress. They point out that a far lower proportion of low-income Americans vote than high-income people. So, from what will a democratic revival spring?

Hacker and Pierson have dedicated their careers to reminding Americans of the purpose of government. Their book should help the nation make some headway.

Jeff Madrick, Fellow

Jeff Madrick is a fellow at The Century Foundation and director of the Bernard L. Schwartz Rediscovering Government Initiative.