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On economic growth, (government) size matters

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There has been a wealth of academic studies demonstrating that larger, more intrusive governments reduce not only economic freedom but also economic growth. But the latest such report comes from a somewhat unexpected source: the Organization for Economic Cooperation and Development. The Paris-based bureaucracy has often advocated more interventionist policies, but occasionally it gets one right, as in this case, Daniel J. Mitchell, economist and senior fellow at the Cato Institute, points out.

"Larger governments are associated with lower long-term growth," the OECD found. Moreover, some types of government spending, like pensions and subsidies, are worse than others.

"Reducing the share of pension spending in primary spending yields sizeable growth gains with no significant adverse effect on disposable income inequality," the authors contend. "Cutting public subsidies boosts growth, as public subsidies … can distort the allocation of resources and undermine competition."

Even middling cuts in government can be significant, as "… a reduction of the size of government has a positive, but moderate effect on the income of the poor. The average disposable income also rises," the economists state. In more bloated, ineffective governments, "a moderate reduction in the size of government would have a large growth effect, so that it would lift all boats." OECD nations with the biggest governments — including Italy, Greece, Hungary, France and Slovenia — could increase their GDP by 20 percent or more by modestly reducing government to the level of other not-quite-as-big-government OECD countries.

Finally, market-oriented policies in some areas can mitigate bad fiscal policy in other areas. The authors cite as an example Sweden, where "the mix of growth-friendly structural policies … may have offset the adverse growth effect of a large government sector."

As Cato's Mitchell adroitly sums up, "In other words, the moral of the story is that smaller government is good and free-markets are good. Mix the two together and you have the best of all worlds."

The sad thing is that the U.S., with its $4 trillion annual budget and nearly $20 trillion national debt, is actually much better off than most OECD countries. Unfortunately, we're catching up fast and headed the wrong way toward more intervention and less economic freedom — and growth.