Tax and Spending Issues

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Can We Determine the Optimal Size of Government?

The massive spending programs and new regulations adopted by many countries around the world in response to the economic crisis of 2008 have drawn renewed attention to the role of government in the economy. Studies of the relationship between government size and economic growth have come up with a wide range of estimates of the "optimal" or growth-maximizing size of government, ranging anywhere between 15 and 30 percent of gross domestic product (GDP), says James A. Kahn, the Henry and Bertha Kressel Professor of Economics at Yeshiva University.

Kahn's paper argues that such an exercise is ill conceived.

> Modern growth economics suggests, first, that government policies leave their long-term impact primarily on the level of economic activity, not the growth rate.
>
> Second, it suggests that the sources of this impact are multidimensional and not necessarily well measured by conventional measures of "size," such as the share of government spending in GDP.
>
> In fact, measures of economic freedom more closely relate to per capita GDP than do simple measures of government spending.

The evidence shows that governments are generally larger than optimal, but because the available data include primarily countries whose governments are too large, it cannot plausibly say what the ideal size of government is. The data can realistically only say that smaller governments are better, and suggest that the optimal size of government is smaller than what we observe today.

Source: James A. Kahn, "Can We Determine the Optimal Size of Government?" Cato Institute, September 14, 2011.

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