Regulation, big government, public debt: not so benign [1]

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What is it about Cambridge University economists? They've always been bad, but they seem to be waging some kind of orchestrated campaign right now. Every time one speaks (like Michael Kitson at this week's Economic Research Council Hayek-Keynes debate), they seem to produce the same sound-bites, designed to assure us that regulation, big government and public debt aren't so bad.

The first petition in the litany is: There is no such thing as a free market. All markets have rules, and couldn't work without them. So there's nothing wrong with government intervention in markets. That's crazy. All police forces have corrupt officers, but that doesn't mean we should have more corruption. It's true that markets only work if people respect certain rules ? the basic rules of property, honesty and contract, which are happily agreed on by market participants. Government intervention beyond that is usually counter-productive (like the vote-seeking price controls now being canvassed in energy: remember the California blackouts, and invest in candles).

The second is: The British government debt was much higher, as a percentage of GDP, after the Second World War. And we paid that off. So don't worry about adding to the debt either. Hmmm. It took us 50 years to pay off all that debt. And at least it bought us victory over Nazism. All we have to show for today's borrowing is a bigger government and a few dud banks. And Britain's GDP was pretty shot after the War, making the debt a much higher percentage of it. Today's £1.16 trillion is no mean debt ? and even that is just the official figure. Add in pension liabilities and all the rest and it is six times that. Affordable? Not if we keep adding to it as we're doing, and less so if and when interest rates rise. It's a dangerous risk.

The third is: Big-government countries like France grow just as fast as small-government countries like Britain. So we shouldn't worry about growing government either. Oh yes we should. There won't be much business done without defence, justice, so countries with some government spending on these things grow faster. But too much, and growth is damaged. It's called the Rahn Curve. A 2009 study of 15 EU countries put the sweet spot at about 30% of GDP [3]. A 2008 study of 21 OECD countries found that higher taxes reduced growth [4]. A 2011 report on 145 countries over half a century found that a 1% of GDP tax rise cut private investment and consumption by twice that amount. [5] Andrew Sentance of PwC found that a cut in taxes produced growth and inward investment. [6] And so on. Keynes himself thought the sweet spot was government spending no higher than 25% of GDP. Ours today is twice that. Cambridge economists please

note.

And another thing

Oh, and one last thing that Michael Kitson told us the other day, and which Cambridge economists go on about. It runs roughly: Adam Smith only mentioned the 'invisible hand' once in The Wealth of Nations'. That means it obviously wasn't a big thing for him. So stop going on about it as if it explains everything. This again is utterly wrong. And not just because Smith mentioned it earlier, in The Theory of Moral Sentiments ? or that it appears slap in the middle of both, which some folk think is significant.

No: in neither case does it really mean quite what we use it to mean today. But read The Wealth of Nations. Even if Smith never mentioned the 'invisible hand' even once, there is no escaping the fact that this is what the whole book is about. It is about people pursuing their own self-interest and as a result ? without specifically intending to ? benefiting others too. After all, nobody would voluntarily enter into an exchange unless they thought they would benefit from it. Market exchange benefits both sides in the deal. Government regulation, price-fixing or outright bans on trading eat into that benefit. Such intervention comes at a cost.

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