Appendix VII – Myth Busting

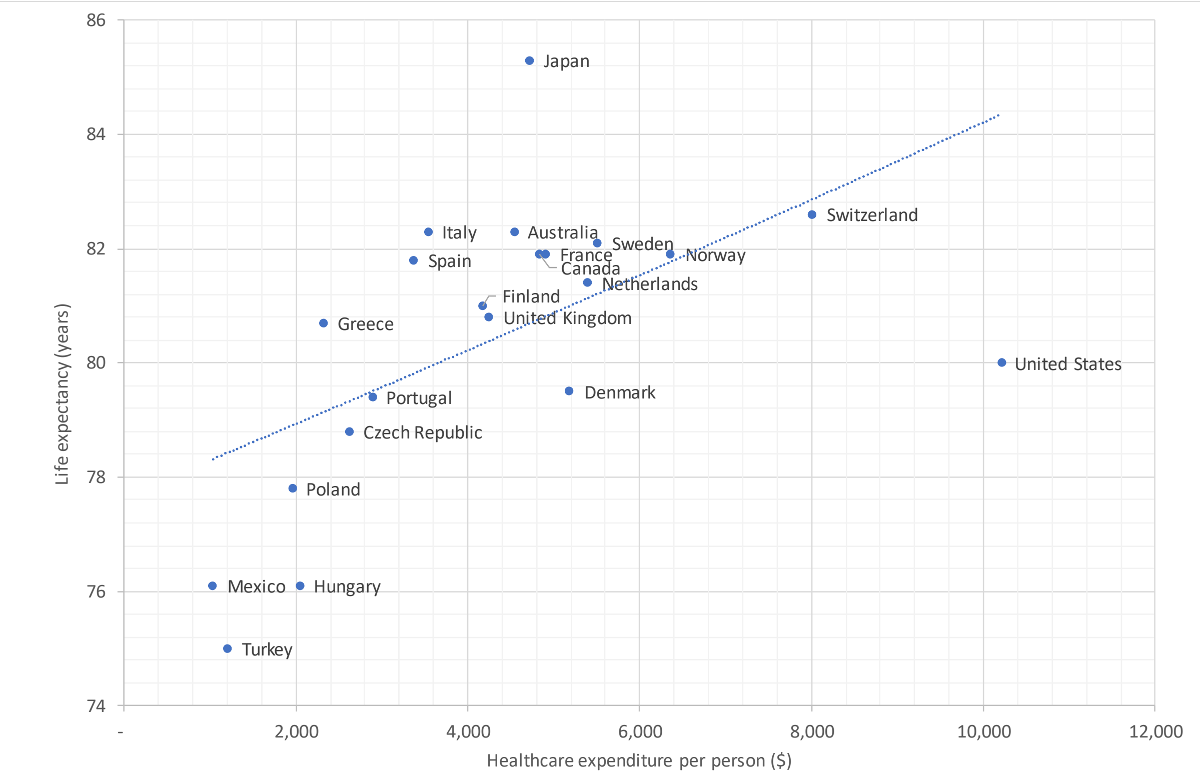
Is the Private Sector Always More Efficient?

It is a commonplace observation that large government departments are highly bureaucratic and often slow-moving, and that inefficiency lurks in every corner.

This is probably true: almost all large organisations are highly bureaucratic, slow-moving and to some extent inefficient. In the UK, for example, the National Health Service (NHS) is often criticised because of inefficient practices, and there is a constant effort to modernise and increase efficiency. This is quite correct, and the constant effort will be required.

It would be quite wrong, however, to conclude that the NHS is inefficient relative to other large healthcare systems, and in particular relative to the – essentially private sector – healthcare system in the United States.

Figure 44: Healthcare efficiency by country



Source: OECD Health Data, 2019[63]

The graph above compares the amount spent per person on health care in each country (adjusted for the different purchasing power of the dollar each country) with the life

[63] (OECD, 2019)

expectancy at birth in that country. On this basis of comparison, the most efficient healthcare system is the Japanese, which gets very good healthcare outcomes for less than $5,000 per head; the majority of developed countries get good to very good outcomes for about $4,000 to $6,000 per head (and the UK spends around $4,000 per head); but the US achieves relatively poor outcomes for a cost of over $10,000 per head.

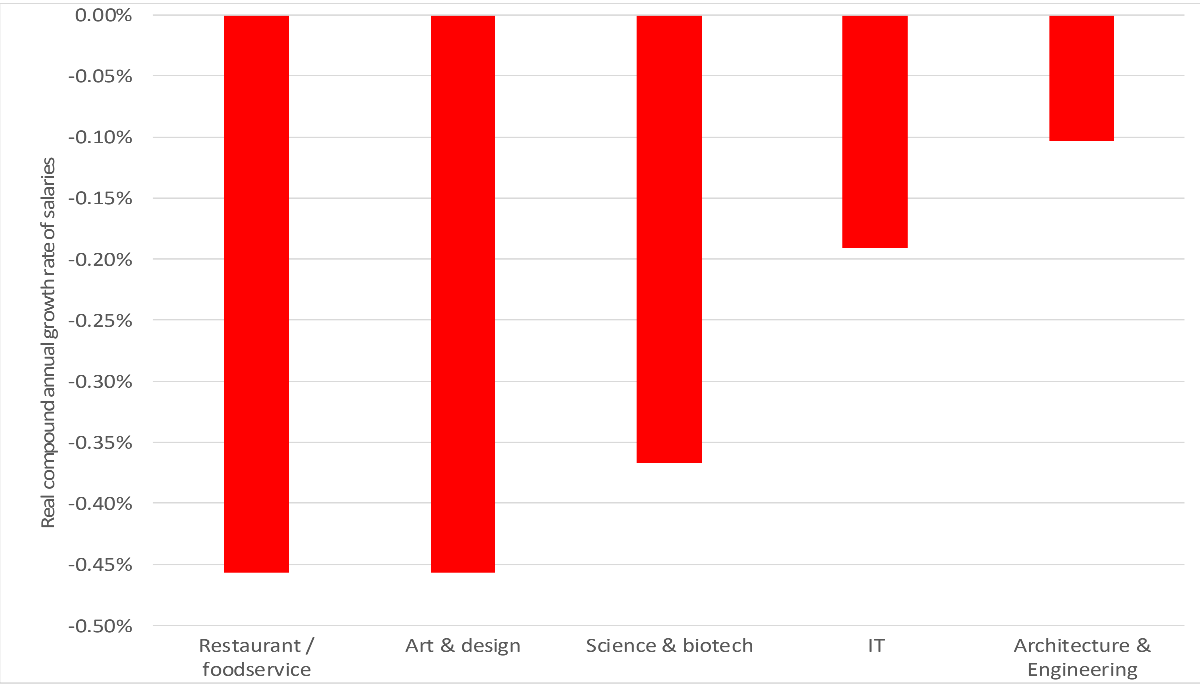
Most other bases of comparison show a similar result: the NHS always comes out as at least a reasonable performer – and occasionally a very strong performer – whereas the US system almost always comes out as a very poor performer.

Does Having The Right Skills Make You Immune From Mass Impoverishment?

If it were really true that there was a desperate shortage of people with STEM skills, it would be reflected in their wages. Even if waiters and bar staff might have to accept falling wages, we would see scientists, IT professionals and engineers enjoying healthy wage growth.

In reality, we do not see this. What we do see is that those with STEM skills have seen their real wages declining more slowly than bar staff – but decline they have.

Figure 45: Annualised change in wages by skill type (US, 2007-17)



Source: Payscale.com[64]; US inflation calculator[65]

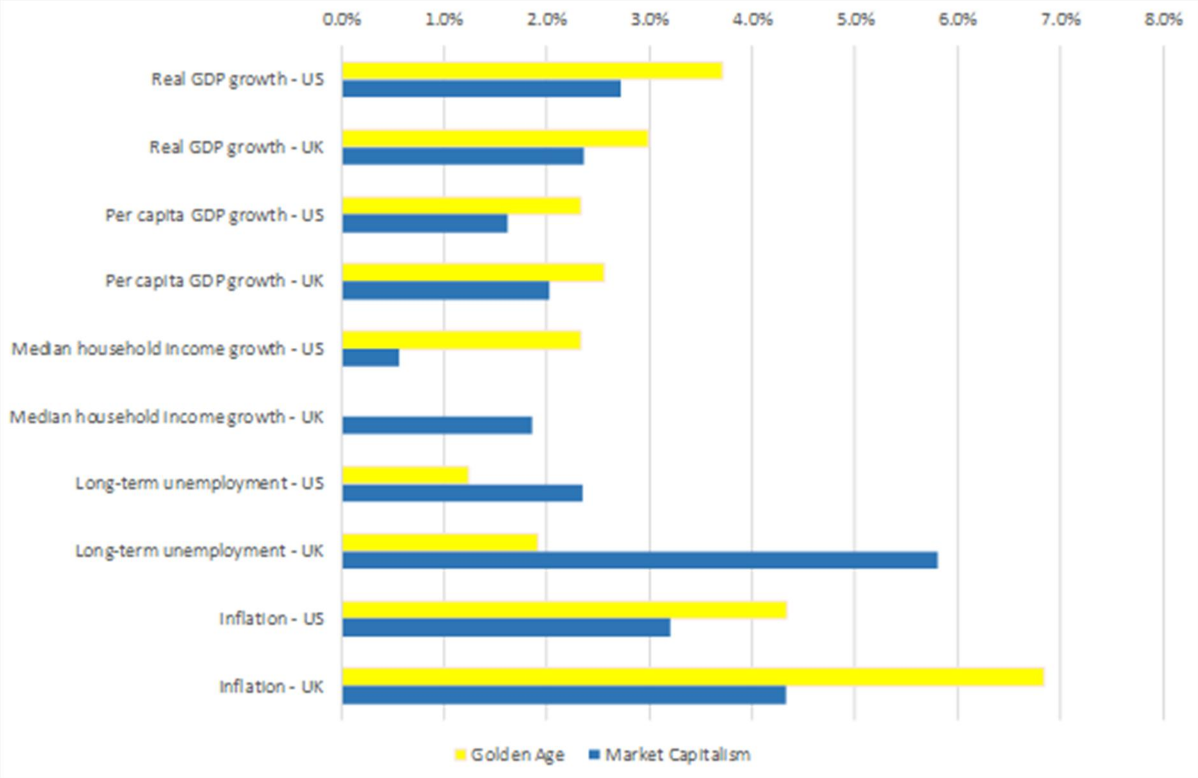
64 (Payscale.com, 2018)
65 (US inflation calculator , 2018)

Having the 'right' skills is better than having the wrong ones, but it is no defence against the threat of mass impoverishment.

Has the Era of Market Capitalism Been a Success?

Looking at the results during the two eras gives us an idea of how well Market Capitalism has worked in practice.

Figure 46: Summary of results from the two eras in US and UK

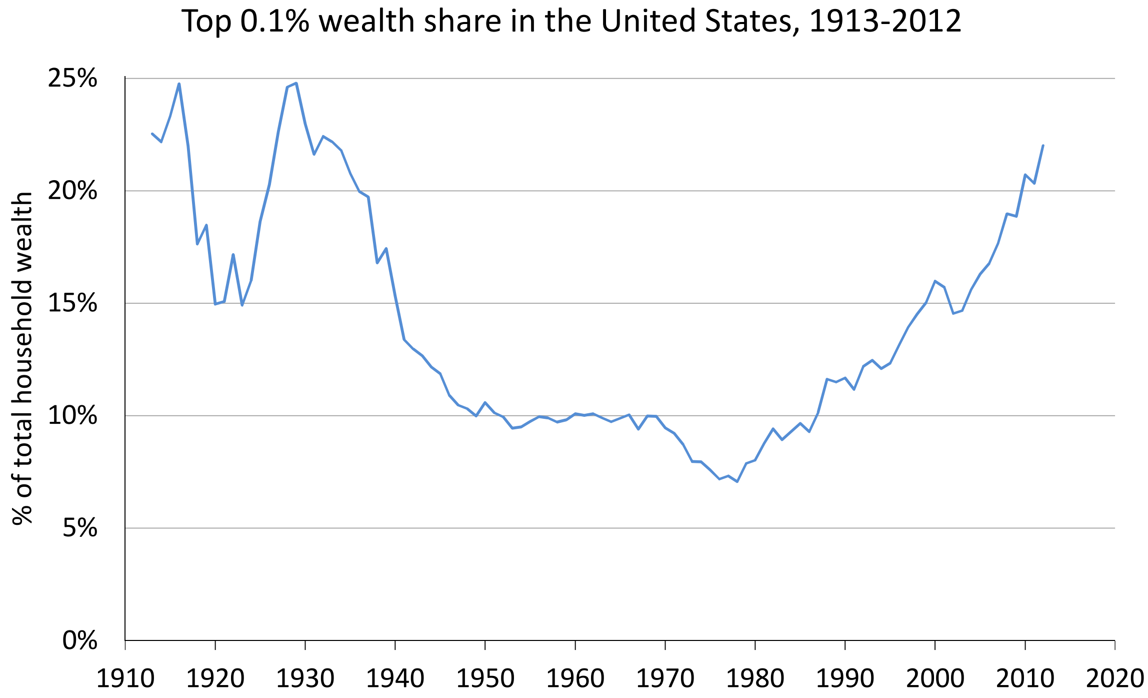


Source: Data from Appendix II

The data lend no support to the idea that the market-based reforms have been of benefit to the mass of the population of either the US or the UK. The *'20 years of economic growth and prosperity'* that Jeff Duncan referred to are not recorded in the data compiled by the Bureau of Economic Analysis, the Census Bureau or the Bureau of Labour Statistics. In fact, what the data show is that the period from 1945 up to about 1980 was indeed a Golden Age of capitalism and has been followed by 35 years of poor results on almost every measure. In summary, the evidence does not support the idea that the simple mental model, "markets are the best way to allocate resources" is a reliable guide to policy-making.

These data seem so much in contradiction with what we repeatedly hear today that it poses the question: if the results during the period since 1980 were really so much worse than those before, why do so many intelligent, successful, well-informed people feel that the market-based reforms were a success? It may be that the chart below contains part of the answer.

Figure 47: Wealth share of the top 0.1%



Source: Saez & Zucman[66]

The top 0.1% of the US population is around 320,000 people. This group includes senior politicians, financiers, top journalists and newspaper proprietors, senior lawyers and top civil servants. In short, it includes almost all of those who have their hands on the levers of power. Many members of this group, as the chart shows, *have* found the last 35 years to be a time of great progress, and most of their friends will agree with them. In a way, it is not surprising that what we hear is the narrative of economic triumph, even though the data show no evidence of any such success as regards the rest of the population.

Did Profligate Governments Cause the Eurozone Crisis?

One of the reasons we think we know that the crisis was caused by profligate governments is that we have been told so many times by those who ought to be in a position to know.

66 (Saez & Zucman, 2014)

"Indeed, it is expansionary policies and weak fiscal positions that created the current problems of high debt and low competitiveness in the crisis countries in the first place."

– Ludger Schuknecht[67]

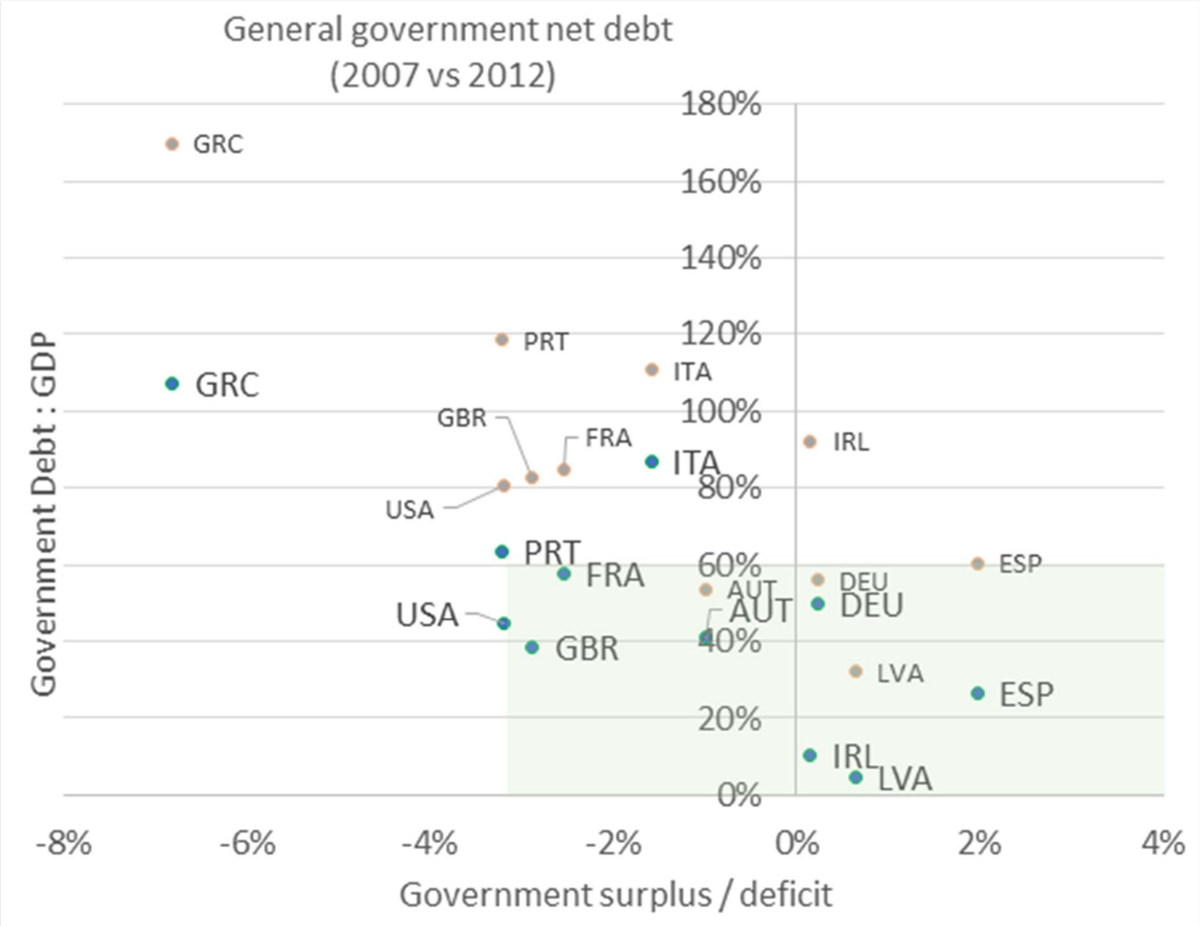
The sentence above comes from a letter from Ludger Schuknecht of the German Finance Ministry to Martin Wolf of the Financial Times. Mr Schuknecht is a senior member of that ministry and an outspoken and confident commentator on economic issues. It is interesting, therefore, to compare his very clear pronouncement with the equally clear data in the IMF database.

The obvious yardstick to use to measure whether a government is behaving prudently or in a profligate way is compliance with criteria 2 and 3 of the Maastricht Treaty to which EU governments signed up in February 1992. Criterion 2 specifies that governments must run a deficit of no more than 3% of GDP; while criterion 3 specifies that the ratio of government debt to GDP should be not more than 60%.

The chart below compares a selection of European countries in terms of their compliance with the Maastricht criteria in 2007 before the crisis broke and again in 2012, at the point where the letter was written. The closer to the bottom right of the chart a country finds itself, the more prudently (according to the criteria) it has been running its economy, and the shaded rectangle highlights those countries which are compliant with the Maastricht criteria.

67 (Schuknecht, 2012)

Figure 48: Government finances before and after the crisis



Legend: larger green markers refer to 2007; smaller amber markers to 2012

Source: WEO database[68]

According to the data, the most prudent governments in 2007 included those of Spain, Ireland and Latvia – three countries hit particularly badly by the crisis, but which were widely praised for their sound economic management at the time. All of these countries were significantly more prudent in 2007 than was Germany. Portugal was also very close to, though just outside, the zone of compliance; and while Italy had a very significant government debt to GDP ratio, its deficit was under control at the time the crisis struck. The UK also lay within the prudent zone before the crisis. Conversely, the United States, the country which recovered most strongly from the global financial crisis was just outside the zone of compliance.

With the single exception of Greece, therefore, there is *no factual basis* for Ludger Schuknecht's comments about the crisis countries: the countries which were hardest hit were principally those which had *not* had weak fiscal positions before the Global Financial Crisis. This disconnection from the facts has in no way reduced the

68 (IMF, 2015)

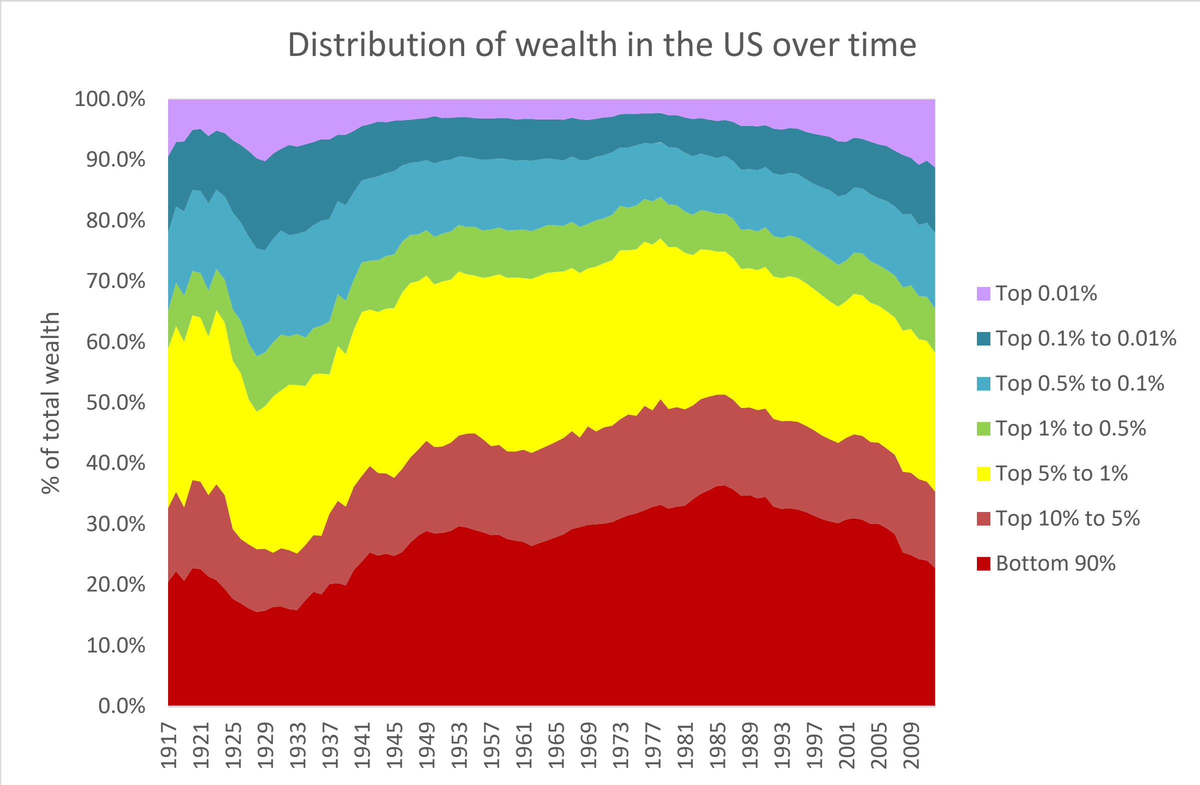
influence of the narrative of previous government profligacy on EU economic management.

Do We Have Less Money Than Before?

It is easy to forget that society as a whole is getting richer. The pie is growing. In real terms, as we saw in Chapter 11, both the US and the UK are richer than they have ever been (and this despite the Global Financial Crisis and the Great Recession which followed it). As societies, *anything they could afford 10 years ago, they can afford now* – and more. Of course, it does not follow that everyone in society is richer, and we saw that a dangerous process of mass impoverishment means in fact that they are not. But the wealth has not disappeared, it merely resides elsewhere.

Emmanuel Saez and Gabriel Zucman have painstakingly worked to understand where the wealth *does* reside in America. Because wealth is so very highly concentrated that missing a few of the very richest people can distort the entire picture, survey-based approaches run the risk of missing a small number of hugely important data points. Saez and Zucman therefore used tax returns to make a comprehensive set of estimates of wealth distribution in the United States since 1913. The results are striking.

Figure 49: How wealth has shifted in the US



Source: Saez & Zucman[69]

The post-war period, and in particular the 1970s, was not a good period for the top 0.01% of the population. Their share of national wealth fell to around 2%. In the 35 years since then, however, it has grown enormously and now stands at around 11%. These last 35 years have also been good – though not nearly to the same extent – for the rest of the top 0.1%. The big losers are the bottom 90%, whose share peaked at around 36% and has now fallen to around 22%. Over the last 10 years, in real terms, the average wealth of a member of the bottom 90% of the population has declined from $66,466 to $58,745. Over the same time period, the average wealth of a member of the top 0.01% has risen from $121 million to $260 million.

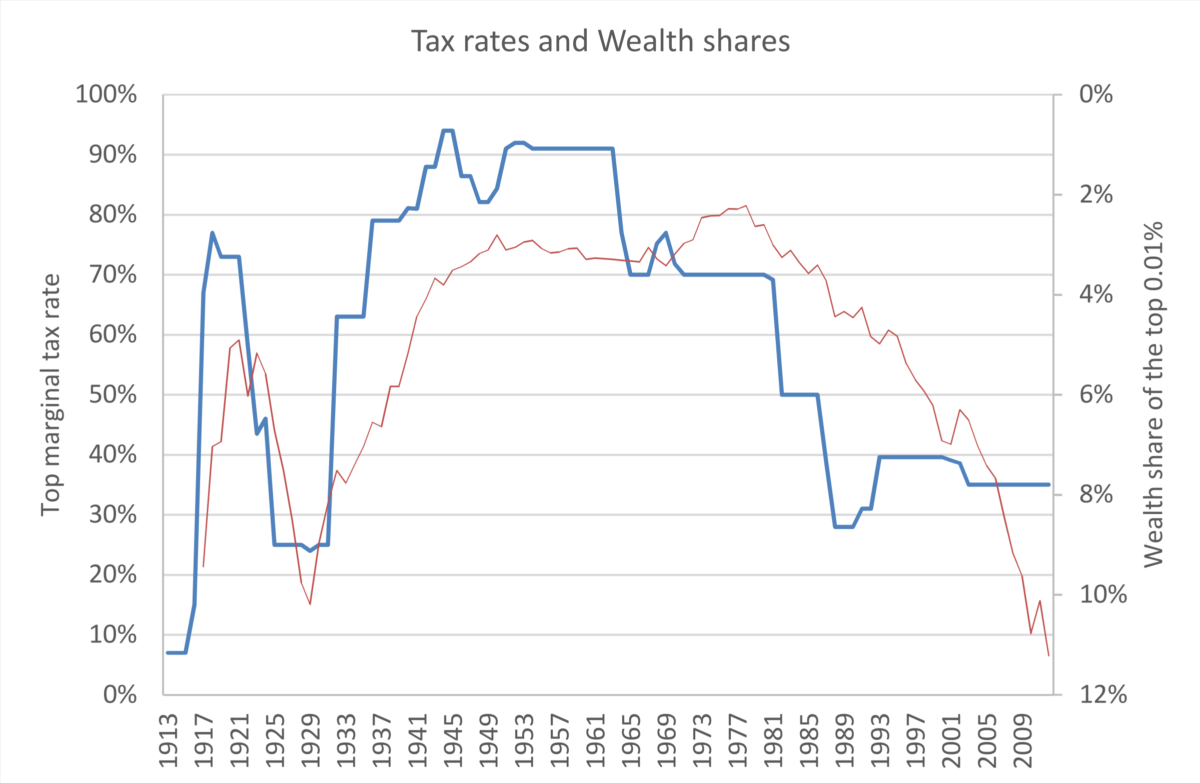
Would Higher Taxation Kill Growth?

We are assured, in the strongest possible terms, that to exercise any of these options would lead to certain and imminent ruin for the nation. It is therefore worth, as always, looking at the facts.

69 (Saez & Zucman, 2014)

First, taxation. The facts on US taxation are summarised in the figure below. Clearly, higher tax rates are not an impossibility in the United States; a top rate of 70% or more was the norm up until about 1980.

Figure 50: History of US top marginal tax rates



Source: IRS[70], Saez & Zucman

A powerful chorus of persuasive voices tells us that the route to economic growth is through lower taxes. Peter Ferrara, former Senior Policy Advisor to National Tax Limitation Committee and now one of President Trump's key economic advisers, believes[71] that there is a clear link between higher taxes and lower growth:

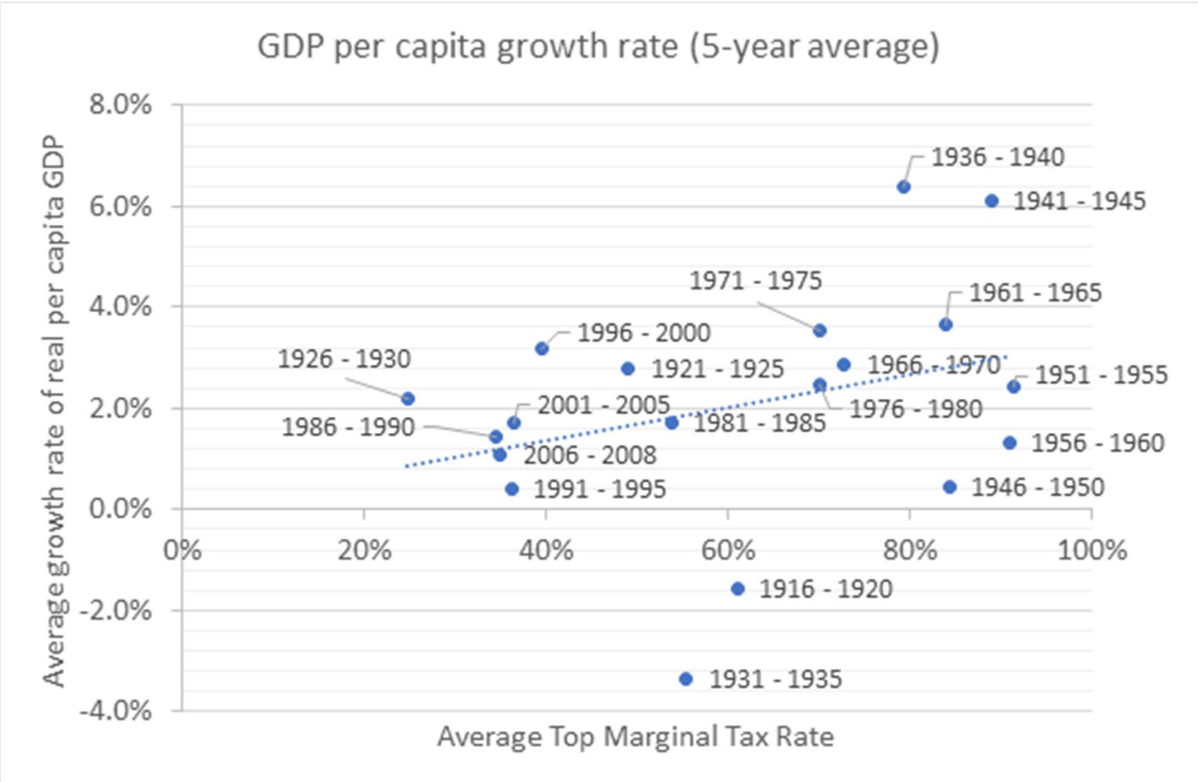
> *"Put most simply, penalizing investors, successful entrepreneurs, and job creators with higher taxes, to reward the less productive with government handouts, to make everyone more equal, is a sure-fire way to get less productivity, fewer jobs, lower wages, and reduced economic growth."*

70 (IRS, 2015)
71 (Ferrara, 2014)

If there were such a clear and simple link[72], it would show up in the facts. For the first 35 years of the post-war period, i.e. during the Golden Age of Capitalism, the top marginal tax rate was at least 70%. As we saw in Chapter 1, the average growth rate during this first 35 years was 1% higher than the average growth rate since taxes have been reduced.

In fact, if we look in more detail at the long-run correlation between growth and level of taxation, what we see is the picture below.

Figure 51: Top Rate of Taxation vs Growth in GDP per capita



Source: Maddison[73], IRS[74]

In the chart above, each point represents one 5-year period and its position shows the top marginal tax rate and the rate of growth in per capita GDP during that period. The two periods of highest growth were 1936 to 1940 and 1941 to 1945, the wartime period during which the economy was actively managed by government. The 1960s and 1970s look particularly good in terms of per capita GDP growth; and the only

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72 If you think about it, a clear and simple link between taxes and growth is unlikely: Governments usually tax in order to spend, and fund tax cuts by cutting spending. A tax cut leaves more money in the economy, which helps growth, but the spending cut removes money which damages growth. Conversely a tax rise takes money out, but a spending increase pumps money in, which helps growth.
73 (World Economics, 2015)
74 (IRS, 2015)

period since then which has come close to matching this time was the period 2001 to 2005.

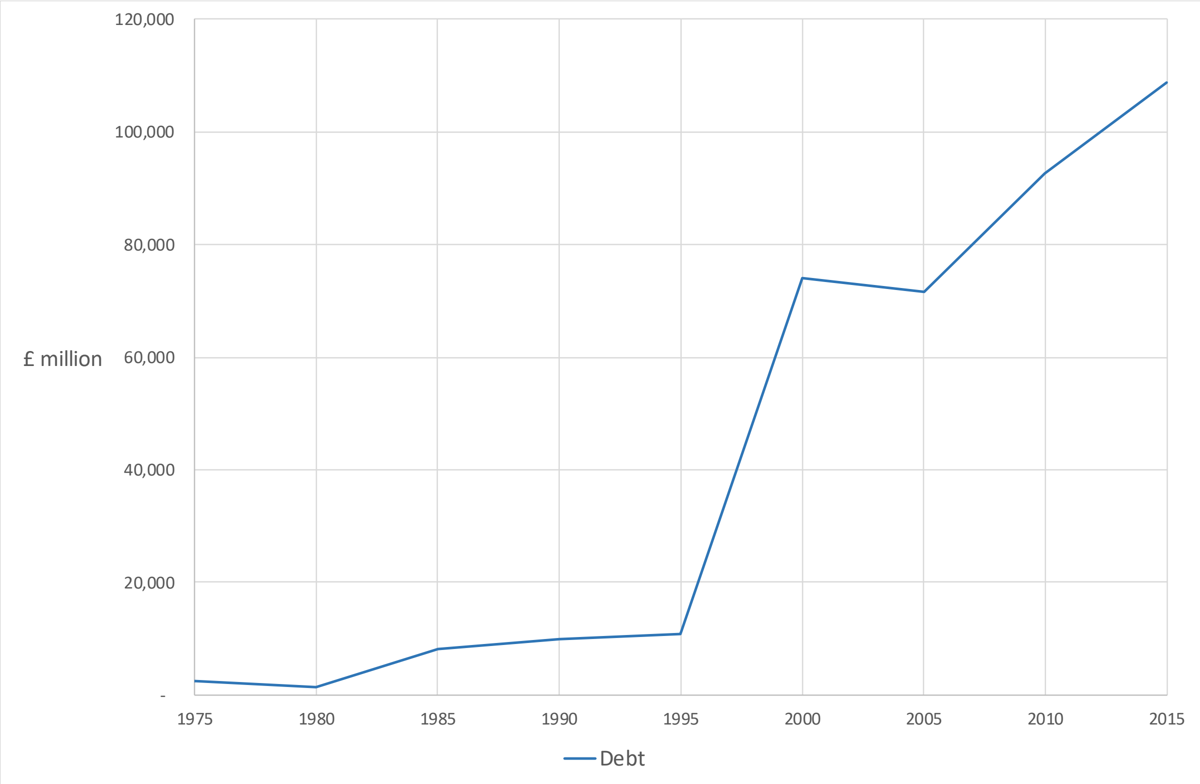
In other words, the data show no evidence whatsoever of any trade-off between the top rate of tax and medium-term growth, in fact quite the opposite: there is a tendency, shown by the line of best fit, for higher growth in years where the top tax rate is higher. This is probably because higher taxes (and spending) tend to redistribute money from the very wealthy, who like to save a significant proportion of their income, to normal families (or as Peter Ferrara calls them, "the less productive") who need to spend a higher proportion of it[75] – in other words, more economic activity is driven per dollar when those dollars go to the middle class than when they go to the very wealthy.

What Would Happen If Businesses Borrowed Like Governments?

The claim that businesses cannot run with an ever-expanding debt is equally nonsensical. As businesses grow, they typically *do* take on more debt, often over many decades. BP plc, for example, originally founded in 1909 as the Anglo-Persian oil Company, has seen its debt grow dramatically over the years. The period since 1975 is illustrated below.

75 (Dynan, Skinner, & Zeldes, 2004)

Figure 52: The growth in BP's debt (at five-year intervals) since 1975



Source: Companies House[76]

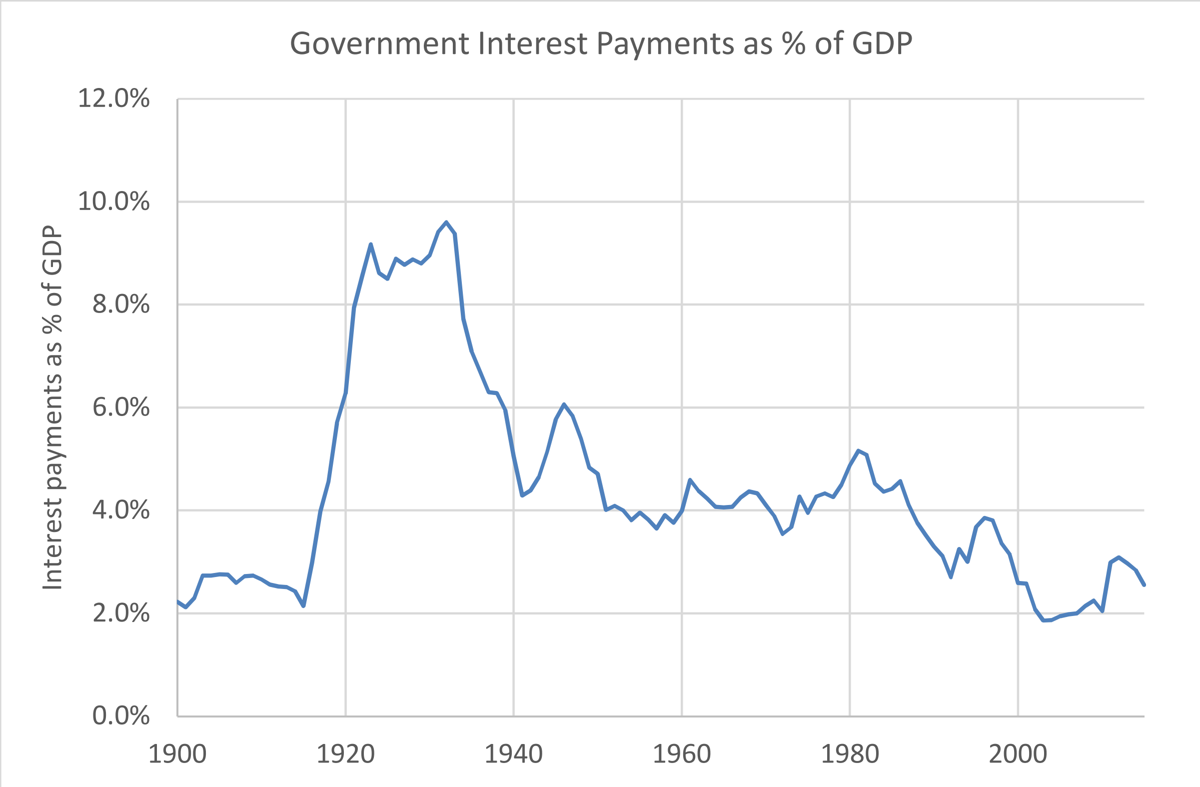
BP's debt was 44 times higher in 2015 than it was four decades earlier in 1975; in the 'no-nonsense' language of UK Debt Bombshell, they have been maxing out a new credit card almost every year. And BP is not unusual in this respect: many large companies grow their debt year after year – and, of course, they are not declared bankrupt.

Will The Interest Payments Cripple Us?

The cost of the interest on all this debt, we are told, will constitute an unbearable burden on our children and grandchildren. We owe it to them to take tough measures now. Again, the facts do not support this narrative.

76 (Companies House, 2016)

Figure 53: Cost of Government Interest Payments over time



Source: Chantril[77]

In fact, because interest rates are so low, borrowing is currently extremely affordable. The cost of a long-term (10 year) UK government bond, at the time of writing, was 1.85%. Any investment which would return more than 1.85% would, if the UK government were directors of a company, be their fiduciary duty to make. A business which had opportunities to invest in projects with a rate of return above its cost of capital would take those opportunities.

77 (Chantril, 2015)