Does high tax hinder growth? And does it matter?

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The debate about whether high tax impedes growth seems to be back on the agenda. The Centre for Policy Studies is saying:

Economies with small governments tend to grow faster than those with big governments. This is the conclusion of Small is Best: lessons from advanced economies, by Ryan Bourne and Thomas Oechsle, published on Friday 25 May

They claim:

Econometric analysis of advanced OECD countries for the period 1965-2010 finds that a higher tax to GDP ratio has a statistically significant, negative effect on growth. For example, **an increase in the tax to GDP ratio of 10 percentage points is found to lower annual per capita GDP growth by 1.2 percentage points**. A similarly statistically significant negative effect on growth is found with a higher spending to GDP ratio. Detailed regression analysis stripped out the impact of variables such as investment as a proportion of GDP, the growth rate of the labour force, and the growth rate of human capital.

I'd add, those last points are far from the only issues that needed to be controlled for.

It's interesting that IPPR addressed this issue this week, responding to the Taxpayers' Alliance / IoD report that claims the same thing, **saying:**

The central claim of the [TPA] report is that lower taxes lead to higher growth. Unfortunately, the empirical evidence doesn't support this view. The world's leading authority on the development of welfare states and public services since the 18th century, **Peter Lindert, puts it like this:**

'Across countries and over time, the coefficients linking growth to total government size are not negative, even in sophisticated multivariate analysis. In the global cross section, richer countries do not tax and spend less … The longer sweep of history also refuses to cooperate. Among the advanced OECD countries, the periods with the fastest-growing welfare states

— between 1950 and 1980 — included history’s best-ever golden age of growth (1950—1973), even though it included the oil shocks that hit in 1973 and 1979. Whether one looks at levels or rates of change, one cannot show any clear negative relationship between social spending and GDP per capita.’

Now the IPPR data is older. So is the CPS right? I personally don't think so. There are three reasons. First, growth is not a useful measure. I distributed unequally growth can be positively harmful. Second, the large / small split looks very arbitrary. Third, the criteria selected for appraisal e.g. school results assume we're all just cogs in the giant production machine. That may be the CPS view. But it sure as heck is not mine. In summary: the data is ambiguous. The answer is subjective. And then we come down to qualitative issues and not quantitative ones - and of course we could all live in the unequal world the Taxpayers' Alliance and CPS want, but ordinary people will never vote for it. Which is why they hate democracy so much.