THE PATH TO SUSTAINABLE GROWTH

LESSONS FROM 20 YEARS GROWTH DIFFERENTIALS IN EUROPE

PART 4 - LOOSING OVERWEIGHT: A SLIMMING CURE FOR FAT GOVERNMENTS

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Part 4 - Loosing Overweight: A Slimming Cure for fat Governments.

In previous chapters we found the empirical evidence that excessive public spending is by far the most important factor responsible for slow growth; much more important even than more obvious factors such as level of education, interest rates or even participation rate. The damage of excessive government however is no longer confined to lagging economic growth. Attentive observers notice Europe's decay spreading to all aspects of society: science, culture, unemployment, and more recently also in the development of a deep moral crisis. Less than a century ago, Europe was the centre of the world's knowledge. Today Continental Europe has only one university left in the world's top 40.[1] French, German, Italian, Spanish, Belgian students now have to travel abroad if they want quality education. Less than a century ago France was the world's capital of culture, fashion, science, arts and technologic progress. Today France is close to social collapse, and is no longer capable to preserve the monuments and artefacts its great culture once created.

But Europe's decay is above all moral. Birth rates are low, suicide rates are high and the pandemic of depressions and the mass consumption of anti-depressive medication are all symptoms of a generalised and deep malaise. The symptoms point at dissatisfaction of very existential needs and at alienation of the individual from his deepest aspirations:

- **Excess regulation is indeed deeply frustrating the Europeans' dignity and their moral pride to control their own actions and social behaviour. In doing so, over-regulation is ripping the individual from his most existential and inalienable value as a free and responsible being.**
- **Europe's excess quantity and complexity of laws -far beyond human capacity of comprehension and obedience- is causing permanent feelings of serfdom, legal insecurity, fear and guilt.**
- **But also the excessive public interference with the citizen's most private affairs and the brutal intrusions in his personal and financial privacy are most grave violations on his fundamental rights and values.**
- **However the gravest cause of Europe's malaise and citizen's discontent is the extreme seizure of the fruit of his labour. Excessive taxation is squeezing family budgets, not only undermining their self-reliance capacity but also driving families in a diabolic rat race. Keeping a decent standard of living now requires two full time wage earners per household, leaving families too little time and energy for the realision of his deepest and non-material values; for a decent family life and social life, for the education of their children.**
- **Lastly high tax levels are also undermining social cohesion by monopolising solidarity in the anonymous social security system. The obligatory participation in the over-centralised and highly inefficient public "social agencies" is indeed depriving the Europeans of the resources for personal solidarity with the ones they really care for. In doing so, the funding of obligatory solidarity is crowding out voluntary, informal, more efficient and real solidarity, and is deeply frustrating personal feelings of sympathy with citizens who are truly in need.**

In previous chapters we found the empirical evidence that this excessive government interference negatively affects the well functioning of society. We found excessive government resulting in slower economic growth and slower job creation. Economic evidence is indeed overwhelming that excessive government spending and over-regulation are Europe's severest handicaps for progress and well being and that reducing Europe's size of governments to their optimal level is urgent. Remains the question how the cancer of excessive government can be confined.

How NOT to do it: Starving the beast.

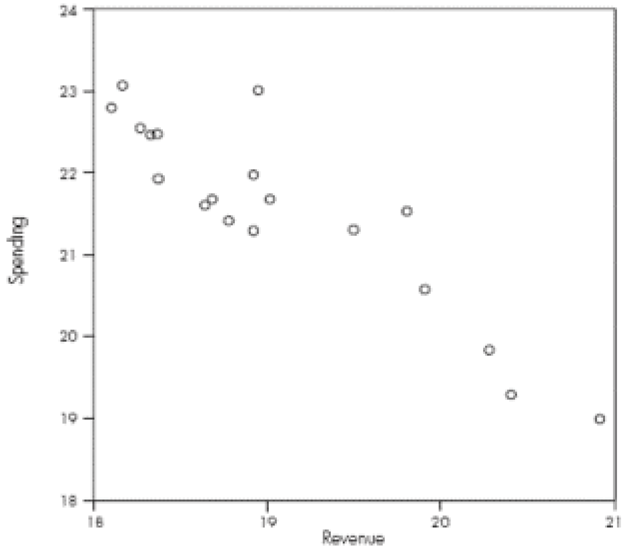
Parents can control the spendthrift of their children by cutting their allowance. For governments, that would mean cutting government's tax-receipts. Unfortunately this way of controlling excessive government spending is not working as governments have easy access to alternative means of financing their spending: borrowing. Reducing tax revenues without a simultaneous reduction of public spending only shifts the burden of current public spending to future generations— including our own children and grandchildren.

From a moral point of view laying the burden of one's overspending on minors not represented in the decision process, is noting less than a taking without their consent. So morally it matches *theft* and the victims of this theft being minors one may denote it as budgetary child abuse.

[1] http://ed.sjtu.edu.cn/rank/2005/ARWU2005_Top100.htm

Empirical evidence[2] (Niskanen, 2002) indeed shows that tax cuts at first tend to lead to even bigger government and increasing public debt. Growth data covering the last decades show there is a significant negative relation between growth in relative levels of public spending and the growth of tax revenues. So when taxes are cut, public spending at first tends to increase rather than decrease. The obvious explanation of this negative relation is that both public demands for public initiatives by special-interest lobbying and the willingness of politicians to consent to those demands tend to increase when the pain of current taxation starts to fade away. So the more the tax burden is put on future voters not effectively represented by those making the current budgetary choices, the more demands for new public initiatives will tend to increase.

Figure 10.1
Federal Spending and Revenue as a Percent of GDP
1981 through 2000



The basic idea behind financial sustainability and the morality behind inter-generational solidarity is that every generation should pay for its own consumption. So except for investments with trans-generational benefits new debts are morally unacceptable. Therefor strict budgetary control is an indispensable aspect of any government slimming cure.

The soft and easy Approach: a Budget Freeze.

So the most obvious and moral strategy to reduce the size of government is to gradually cut tax rates and simultaneously prevent public spending from rising through a strict budget freeze. Tax cuts cause the private sector income to rise and motivation and participation to increase. This automatically sets in motion a dynamic growth-effect, so that unchanged government spending can decline relatively as a percentage of national income. So a budget freeze is a much more common-sense tactic to limit public spending, than attacking the government's budgets with a paring knife in a static or even declining economy.

For the past century public budgets have grown much faster than the economy as a whole. Contrary to the conventional wisdom, there is no law of nature, or economics, or politics that requires the public sector to grow every year, nor to follow the growth rhythm of the economy as a whole. On the contrary, progress over the last century has progressively reduced poverty and in doing so increased people's self-reliance capacity, progressively making the least productive programs of the Nanny State fully redundant.

Public agencies will of course loudly protest a spending freeze, arguing it means squeezing out funding for vital programs. However a budget freeze does not mean a cut in budgets, but merely a stop to its rise in real terms. So a budget freeze still allows for compensation for the cost of living. Only new types of public initiatives or spending on *néw* programs can no longer be launched without abolishing obsolete ones.

A strict budget freeze at the present level has three advantages: First it is the most painless and softest way to start the slimming cure. Second advantage is that public agencies finally would be obliged to introduce the concept of productivity in public management. Knowing the precise constraints of their budgets, authorities would be obliged to make optimal use of available resources, just as any private businesses or household must do. But the main advantage is that citizens finally see a glimpse of the light at the end of the dark tax tunnel. A budget freeze restores hope that some day Europe's tax misery may come to an end, and the tax burden will be lowered to a sustainable level. A budget freeze takes away the citizen's fear that in the end the fruit of his labour will be taken anyway. The Irish example shows that as soon as this confidence returns and incentives are restored, growth starts to pick up immediately.

[2] http://www.cato.org/pubs/handbook/hb109/hb_109-10.pdf

In the table below we make a simulation on the cumulative effects on economic growth of a budget freeze. The effects are remarkably fast and dramatic when the growth effect resulting from a relative decline in government spending are taken into account. Calculations below are based on a conservative, a realistic and an optimistic growth effect. The most optimistic scenario is based on a (growth) / (size of government) elasticity of only half of the elasticity found in the regression analysis. Even under this very moderate assumption of a growth elasticity of 0,4, the simulations shows a fast increase in GDP growth rate, resulting in a sharp decline of relative public spending. After 7 years only a country with 50% of government spending sees its public spending reduced to the OECD average of 40%. So a budge freeze, however soft the approach may be gives much faster results than one generally expects.

Simulations of a Budget Freeze.

Conservative growth effect					Realistic growth effect					Optimistic growth effect				
Elasticity Growth/ Size of Government:				1,0025	Elasticity Growth/ Size of Government:				1,004	Elasticity Growth/ Size of Government:				1,0057
	GDP	Real Public Spending	Relative State Budget	Growth rate		GDP	Real Public Spending	Relative State Budget	Growth rate		GDP	Real Public Spending	Relative State Budget	Growth rate
2005	100.00	50	50	1.017	2005	100.00	50	50	1.017	2005	100.00	50	50	1.017
2006	101.70	50	49.16	1.020	2006	101.70	50	49.16	1.021	2006	101.70	50	49.16	1.023
2007	103.69	50	48.22	1.022	2007	103.84	50	48.15	1.025	2007	104.02	50	48.07	1.029
2008	105.98	50	47.18	1.025	2008	106.45	50	46.97	1.029	2008	107.00	50	46.73	1.034
2009	108.59	50	46.04	1.027	2009	109.57	50	45.63	1.033	2009	110.69	50	45.17	1.040
2010	111.54	50	44.83	1.030	2010	113.22	50	44.16	1.038	2010	115.16	50	43.42	1.046
2011	114.87	50	43.53	1.032	2011	117.47	50	42.56	1.042	2011	120.49	50	41.5	1.052
2012	118.58	50	42.16	1.035	2012	122.36	50	40.86	1.046	2012	126.79	50	39.44	1.058
2013	122.72	50	40.74	1.038	2013	127.97	50	39.07	1.050	2013	134.18	50	37.26	1.064
2014	127.33	50	39.27	1.040	2014	134.37	50	37.21	1.054	2014	142.81	50	35.01	1.070
2015	132.44	50	37.75	1.043	2015	141.65	50	35.30	1.058	2015	152.86	50	32.71	1.076
2016	138.09	50	36.21	1.045	2016	149.93	50	33.35	1.063	2016	164.55	50	30.39	1.083
2017	144.35	50	34.64	1.048	2017	159.32	50	31.38	1.067	2017	178.14	50	28.07	1.089
2018	151.27	50	33.05	1.051	2018	169.98	50	29.41	1.071	2018	193.96	50	25.78	1.095
2019	158.92	50	31.46	1.053	2019	182.08	50	27.46	1.075	2019	212.38	50	23.54	1.101
2020	167.37	50	29.87	1.056	2020	195.82	50	25.53	1.080	2020	233.88	50	21.38	1.108
2021	176.71	50	28.29	1.058	2021	211.44	50	23.65	1.084	2021	259.03	50	19.3	1.114
2022	187.04	50	26.73	1.061	2022	229.21	50	21.81	1.088	2022	288.51	50	17.33	1.120
2023	198.47	50	25.19	1.064	2023	249.48	50	20.04	1.093	2023	323.18	50	15.47	1.127
2024	211.12	50	23.68	1.066	2024	272.62	50	18.34	1.097	2024	364.09	50	13.73	1.133
2025	225.14	50	22.21	1.069	2025	299.11	50	16.72	1.102	2025	412.5	50	12.12	1.139

Good Governance Practices for improved Public Sector Productivity.

The most painless way for the citizen to control run away growth of public spending, without having to reduce public service is to improve the deplorable and sub-standard productivity of Europe's public sector. Giving better and more services for the same price or at a lesser cost. The opportunity costs of Europe's excessive government are indeed immense. Considering what other benefits could have been achieved if public sector resources had been spent wisely one can reasonably state that all remaining poverty is public sector induced poverty. The case against the big state is not that it spends too much on the welfare of people, but that their welfare would be so much greater if it had been wisely managed and spent in a way the private sector would do it.

The most obvious way to improve productivity in the public sector is to introduce managerial methods from the private sector, which has much better performance records. There is indeed no reason why the principles of good governance of the private sector could not be applied in the public sector.

Ten principles of good governance improving public sector productivity

1. Accountability & Transparency
2. Creating taxpayers value through improved productivity.
3. Pruning the Parasitical Sector
    - Confining the dispute industry.
    - Reducing superfluous bureaucracy.
    - Cracking the Unemployment Trap
4. Directing Public funds at programs with high social value.
    - Public programs benefiting the whole population.
    - Resources for programs with high social benefit
    - Risk management: Excessive resources for statistically irrelevant risks
5. Management at the lowest level of Administration
6. The Separation of Economy and State
    - Abolish all occupational-licensure laws.
    - Privatising what the private Sector can do better:
    - Pruning Subsidies.
    - Confining city planning to its true task.
    - Limiting the interference of pressure groups in our Consensus model
7. Human Resource Management
8. Introducing Incentives & Responsibility in Public Sector
9. Sustainable prosperity

10 Stimulating Tax Competition between Governments

Accountability & Transparency.

The basis of decent management is decent knowledge of the situation, and thus accounting methods giving a reliable picture of the current state of affairs. Obviously governments do not dispose of such accounting methods. In their present form, State budgets are simple statements of revenues and expenses during the fiscal year. These statements would indeed give a reasonable idea of the state's financial situation if all debt and credit would be cashed immediately. However in reality governments do not pay cash for their debts nor do they receive all taxes of the fiscal year at once. So all governments build up claims of receivable taxes and liabilities they owe towards their citizens, such as pension liabilities, or to creditors abroad. In other words also governments have assets and liabilities.

As a consequence the present form of statements of current revenues and expenses do not provide a true picture of the public finances, and authorities lack the basic, reliable instrument for managerial control of the state's finances. Nor the press or the electorate gets a tansparent picture, so that the democratic process is fundamentally distorted.
As in every enterprise that does business on a delayed payment terms, only a full balance sheet can reflect the accruals of claims and debts and the real soundness of the state's finances. So there is absolutely no reason why the Generally Accepted Accounting Principles (GAAP) should not apply for the public sector as well, or at least accrual accounting should be introduced in the public sector.[3] Indeed what governments consider indispensable for the smallest of street corner grocery stores is even more necessary for the biggest of its organisations: the state itself.

In private Business, the balance sheet serves as the prime source of information, giving early warnings of developing calamity, and signalising whenever corrective action is necessary. For reasons of sustainability and financial stability of the country, as well as transparency, yearly full public financial statements including the balance of the state's assets and liabilities are indispensable. It would allow timely detecting risks or to discover excessive indebtedness, fight corruption, abuse of public funds, and give true information on how well government is running its business. Under the present form of state budgets, governments all too often hide current layouts and transform them in future debt undetectable for the average voter. A full balance sheet would give a true idea of the state's financial situation, and give the voter and taxpayer a transparent picture of the effectiveness of the government in office. So in the next election thanks to the transparency provided by the states' balance sheet voters will know whether to reward the government in office or to send it away.

[3] http://europa.eu.int/comm/budget/library/documents/implement_control/reference_documents_accounting/statement_gray_en.pdf

Differentiating Core Business from side-Tasks

Ever since the ancient Greeks invented democracy, citizens have entrusted collective tasks to their governments such as public safety, law and order, justice, road building, defence and the like. Only very recently, roughly since WW2 in fact, governments progressively became involved also in the business of providing private services such as healthcare, education, public transport. They even joint the private sector in very commercial activities such as steel making, mining, energy, telecommunications, research and even lotto-gambling. Some Governments even engaged in most sensitive activities such as providing "independent" news and information, subsidising specific cultural events, and even in the business of spying on their own subjects whose privacy they were supposed to protect.

In other words since WWII, our governments-shopkeepers have become all-round DIY handy harrys, taking care of every detail going on in their business. The main problem with such handy harry shopkeepers is that they progressively spend ever more time and efforts on side-tasks, wasting the benefits of specialisation and external craftsmen executing these side-jobs much better and much more efficiently. But most gravely, such handy harry shopkeepers loose the supervision and the interest for their core business. This is exactly what happened with the European government expansion since WWII. What once used to be government's only tasks, no longer even is considered as core business. Our handy-harry-governments got involved in such a wide range of activities which consumed so much of their time, efforts and resources, that the core business only gets done after all these other things are finished. In other words, the shopkeeper only gets to his core task of serving customers, after having finished programming his computers, and after having gone through the mails of all of his staff.

European Governments operations have indeed grown to such an unmeasurable scope, complexity and size that they symply have become unmanagable. Governments have become the new dinosaurs rushing through Europe's landscape. Hordes of busy clerks and bureaucrats are mailing about, industriously passing papers to and from and filing documents no one will ever read. In Belgium the bureaucratic beast has grown to such an absurd size and complexity that the Brussels court of appeal last year handled no less than 17 cases opposing the Belgian State versus the Belgian State. So restraining to the core business is the first and most obvious task in making governments manageable.

Creating taxpayers' value through improved productivity.

Contrary to popular belief, the poor productivity in the public sector is not primarily resulting from the laziness, slowness or incapacity of its civil servants. On the contrary, most civil servants work hard and conscientiously. Low productivity in the public sector is due to poor organisation and above all to civil servants being ordered highly unproductive tasks, in activities the private sector could do much better, or even being employed in the fully counterproductive jobs of harassing people and businesses.

The public sector not being subject to the laws of the market, by its very nature lacks the incentives for creativity to create market value, or to improve its organisation and performance. So malfunction or under-performance in the public sector not being sanctioned by markets unproductive public programs and low-productive activities can indeed persist forever. Even hard and efficient working civil servants can indeed be highly unproductive. When a minister orders half of his staff to dig pits, and the other half to fill them, the minister's servants indeed will all have full time and hard working jobs. Still from a macro-economic point of view the productivity of the minister's team would be zero. Although the absurdity is less evident for the inexpert eye, exactly the same happens when authorities create all kinds of superfluous bureaucratic procedures, or engage resources and personnel in programs with little or no added value. An example may be the case of a finance minister hiring the best university graduates in order to improve the effectiveness of the fiscal controls. The result of the minister's initiative is that after a while, taxpayers, rather than caring for their tax returns themselves, tend to call in well-informed accountants to have their fiscal rights defended with equal arms against the minister's new university recruits. Also the accountant offices tend to respond to the minister's initiative by recruiting highly expert tax lawyers, instead of relying on just accounting graduates. The final result of the whole escalation round generally is a zero-sum. Not a single penny more for the Treasury, and not a Penny more in the taxpayer's pocket. Only both the Treasury and the taxpayer now have to pay for their new recruits and fiscal experts.

Although both the treasury's civil servants and the accountants staff work hard and scrupulously, and both are convinced to serve a noble cause, the macro-economic result of their efforts is the same as for the pit diggers: in the end nothing has changed; no added value was created. All their efforts and endeavour were pure waste of time, money and resources. So rather than engaging in all sort of such macro-economically useless activities, governments should direct their efforts and public resources to activities that create true macro-economic value. In the end governments were not elected to serve as secure workshops for their staff and managers. Governments are elected to serve the general interest. The obvious first step towards creating added value to the public interest is to reduce all waste in unproductive activities.

Pruning the Parasitical Sector

For the purpose of economic analysis and of targeting public policy, the economy is traditionally divided in three sectors. The primary sector consisting of mining, fishing and agriculture; the secondary sector basically consisting of industrial activities; and the tertiary sector consisting of the service industry including medical services, old age care, maintenance and the like. In recent decades authorities multiplied bureacracy and totally useless activities such as described above to a whole new sector. All these activities have traditionally been classified under the service industry. However this fast emerging sector differs most essentially from the activities in the three traditional sectors by the fact that from a macro-economical point of view they create no added value such as the three productive sectors do. For the purpose of economic analysis and policy these activities can therefore no longer be classified under the traditional sectors. Growing, feeding, and living on the three productive sectors, but in the end contributing nothing to their survival, the new sector can best be denoted as the parasitical sector.

The most obvious part of the parasitical sector consists of the potentially productive citizens, who use social security as a hammock rather than as a safety net. However important in size, this is the least harmful part of the parasitical sector. Although they do not actively contribute to the system's survival, at least they do not hinder the productive sectors in their activities. By far the most harmful part of the parasitical sector consists indeed of the growing administering and legislative device that provides citizens and even their own administration with excessive laws, decrees, guidelines, regulations, and administrative memoranda. Even non-economists understand that if authorities impose a tsunami of new regulations, industries will incur new costs, and in the end will be forced to increase the price of their goods and services. So rather than producing wealth, the legislative part of the parasitical sector does cause serious obstruction to the productive sectors in doing their job of creating wealth.

But there is more. The excessive legislation is necessitating increasing parasitical activities in the private sector as well. Tasks such as learning the growing complexity of the administration, the efforts of conforming industry to these regulations, internal control, monitoring, must be classified under the parasitical sector just as well. Both if these activities of are performed by internal personel or by external service providers who assist the administered in acknowledging and complying to the excess regulation. An important part of the private parisitical sector consists of the massive efforts of service providers giving legal advise and assistance in judicial proceeding concerning such matters and in the comprehensive efforts of avoiding and escaping the excess regulation. Obviously all these types of parasitical activities have always existed. Until a few decades ago this sector was rather limited in size. So the harm caused to the economy was too small to cause major concern. However at its present growth rate, remedial intervention the emerging parasitical sector has become urgent.

The problem is that although creating no real wealth, comfort or pleasure, the parasitical sector's staff must of course be paid for their hard work, albeit they work in -macro-economically- unproductive jobs. Acquiring income without delivering real consumptive value the parasitical sector is indeed the main cause of the paradoxical stagflation. Goods and services of the private sector are indeed accounted for in our GDP at their market value. For public services however, there is no such thing as a market value since these (pseudo) -services are not acquired through free choice, but their consumption is made compulsory by authorities. In the absence of a market value, the comptrollers of the national accounts assume that the value of public service is equal to its labour cost. Obviously this is grotesque over-estimation since most of those services provide little or no wealth, comfort or pleasure, and not a single consumer would consider buying those pseudo-services at their cost price. Most of the "public service" is even perceived by the consumer as administrative nuisance or as meddlesome harassment. In other words such activities create even negative value.

So the market value of "public service" is much lower than its production cost, if not negative. Public service being accounted for at its cost price, Gross Domestic Product (GDP) data are grossly over-estimated, and so is its reported growth rate. In fact the emerging parasitical sector and the ongoing process of formalisation of the informal economy explains for the bulk of Europe's growth figures. This causes an illusion of growth and explains the paradox of real impoverishment while official data indicate that wealth is steadily growing. It explains why ever more Europeans face difficulties in paying their monthly bills, and why the young generation faces such difficulty in acquiring a dwelling. The reality is that Europe's ***real*** wealth has been stagnating over the last couple of decades, and even has been declining in some countries.

Europe's growth figures are indeed no longer readings of its citizens' accrued comfort, wealth and pleasure, but increasingly have become indicators of the growing harassment form the parasitical sector with pseudo-services such as bureaucracy, and the growing costs of public interference with the citizens' most private affairs.

1. Stopping the Exploitation of the Productive Sector

Obviously the parasitical sector lays a hidden but heavy burden on the economy and consequently diminishes its wealth creating capacity. Therefore policy should be aimed at pruning the parasitical sector, and protect the productive sectors from its excessive interference.

The dupery of the parasitical sector is to let productive citizens believe that todays impoverishment is the consequence of the productive sector not working hard enough. As a matter of the primary, secondary and tertiary sectors, with nearly two full jobs per household, and thanks to massive productivity gains, never in history worked as hard and productively as today. Entrepreneurs and workers in the productive sector are pushed to the limits of their physical capacities. Many of them take antidepressive medication, and their households hardly have time left for a decent education for their children....

So the real cause of todays empoverishment is not the productive sector producing too few goods and services, but the fast growing parasitical sector producing no consumptive value at all while hindering the productive sector in their task of producing wealth. The leading classes of politicians, trade unions, professional organisations, bureaucrats, health insurance funds, experts, redistributors, lawmakers and world improvers are indeed all claiming an increasing share in the consumption without them contributing any real added value themselves. Their free riding is the real cause of todays impoverishment.

This exploitation of the productive sector is not only uneconomical. It is also immoral and must be stopped. However priorities should be set in pruning the parasitical sector. The least productive public programs are to be abolished first. Most importantly one has to distinguish between the counterproductive public programs and the activities with low added value. Whereas overall productivity of public service can be improved by increasing the efficiency of programs with low added value, increasing the efficiency of counterproductive activities only ads tot the overall public counter-productivity. Low productive programs should be abolished only when alternative work can be found for the civil servants in jobs with larger added value. However counterproductive programs should be abolished anyway and anyhow, even when civil servants cannot be made redundant, and even if there are no alternative jobs for civil servants available.

2. Confining the dispute industry.

The most counterproductive legislative initiatives and public programs are those that are likely to cause legal disputes, both between citizens mutually, between citizens and the authorities, and between different levels of authorities mutually. Disputes involving the authorities now account for more than half of all legal disputes in several European countries. This is both remarkable and absurd, as it is the democratic duty of the authorities to defend the interests of citizens, rather than litigating against them.

At the end of any legal dispute no new added value is created. At the most money will be transferred from one pocket into another. Although this transfer requires tremendous resources, time and efforts no new prosperity is created. So the productivity of the dispute industry is extremely negative, and one of the prime public priorities should be to prevent judicial conflicts from developing.

The most obvious causes of legal controversy

- **Excess quantity of legislation, making acknowledging rights and obligations increasingly difficult**
- **Unclear legislation defining rights and obligations ambiguously.**
- **Frequently changing legislation.**
- **Legislation with retroactive effects**
- **Legislation and programs violating fundamental (natural) rights**
- **Legislation and programs violating property rights: expropriations, pre-emtions.**
- **Legislation and programs limiting the use of property**
- **Legislation restraining freedom of contracting or overriding voluntary agreements.**

3. Fighting Bureaucracy.

Just as counterproductive as legal controversy is excess bureaucracy. Excess bureaucracy overcharges the private sector with unnecessary administrative duties, and in doing so keeps workers in the productive sector away from their true task of producing wealth. Excess bureaucracy therefore increasingly reduces the economy's wealth producing capacity.

The most obvious criterion to determine over-regulation is that it should be possible to know the law. In a state of law, ignorance of the law can indeed not provide the excuse for breaking the law. In their diligence to comprehensively steer human interaction, European legislators built up an all-embracing economic, environmental and social planning, all adding to a grotesque stockpile of legislation. This stockpile has now grown to a quantity well beyond the human capacity of comprehension. As a logical consequence, and except for a few highly specialised experts, ignorance of the law and legal insecurity has become the rule in Europe, making every economic activity a legal gamble. (Would-be) Investors and entrepreneurs are in permanent doubt whether they are operating within the law. Is my business legal? Do I dispose of all licenses such as prescribed? Have I not broken an environmental law or some paragraph of the city planning, or some sub-article of the fiscal or social rule? Could judges later not give an interpretation of the law that is different from how I understand it today? Wont some judge later find me guilty of some penal offence? So the cost of legal enquiry is high and the legal uncertainty deters many potential entrepreneurs.

But excessive legislation does not only lead to ignorance on the side of the administered. Also authorities can no longer manage the monstrous quantity of legislation. Budgetary constraints have left them with deficient resources and staff for inventorying, managing, monitoring and enforcing all this legislation. Even judges can no longer keep up with the tsunami, and the State's prime duty of rendering justice is jeopardised. Rather than reducing the quantity of legislation when lack of control make catching offenders unlikely, authorities choose to compensate the low chance of detection through extreme penalisation, hoping this will deter would-be offenders. So even minor administrative mistakes or incidental errors become criminal offences and are sanctioned with confiscation's, imprisonment's and in, the case of city planning often destruction of the "illegal" constructions.

But extreme penalisation does not solve the problem of legal uncertainty on the side of the administered. Under the threat of criminal persecution and of loosing their homes, possessions and freedom, well-informed bona fide entrepreneurs are terrified and quit. Extreme penalisation under legal uncertainty does indeed set in motion a mechanism similar to Gresham's law[4]. Ignoramuses, criminals, and gamblers who have nothing to loose in the adventure of enterprise progressively are driving bona-fide entrepreneurs out of business. In an environment of legal uncertainty only those who dare to rely on the generosity or corruptibility of the law enforcing authorities do well.

Extreme penalisation under legal uncertainty equals despotism. History learned that under despotism business has never flourished. Entrepreneurs do not like to be presumed guilty until proven innocent. When running a business as a good father of the family is no longer sufficient, bone fide entrepreneurs will continue to quit, and potentially successful businesses ideas will never get started up. Over-regulation simply kills creativity, deteriorates the quality of entrepreneurship and hinders the creation of new products and services. Research [5] shows a powerful link between the degree of regulation in the economy and growth in output. Koedijk and Kremers have given convincing evidence of the strong negative link between the degree of regulation and economic performance. The rime objective of policy should be to limit regulation to its essential minimum, and to reduce complexity of legislation of city planning and social and fiscal regulations. A first structural step towards reducing the overproduction of legislation could be to stop at least its growth. So whenever a new regulation is created, an obsolete law must be abolished, and/or new legislation could be given a limited life span, so that the social relevance of legislation must be re-evaluated every five years or so ("sunset clause").

[4] **http://en.wikipedia.org/wiki/Gresham%27s_law**

[5] Market Opening, Regulation and Growth, K Koedijk and J Kremers, Economic Policy 23, October 1996

4. Fighting the Unemployment Trap and Social security Abuse

De-motivation originating in the unemployment trap is a major cause of unemployment, while unemployment benefits are major social expenditures. Most European countries do indeed combine high *average* taxation with strong progressiveness of the tax structure. The *marginal tax rates* under such a tax structure reach prohibitive levels even for midsize incomes resulting in the unemployed being demoralised to participate in the production process. This disincentive to work is even worse in countries where unemployment benefits are generous (Finland), unlimited in time (Belgium), or controls are inadequate or even unexisting such as in parts of Belgium.

> **But there are not only the prohibitive *marginal* tax rates and generous unemployment benefits. Most European social systems add to these disincentives regressive social benefits and even exclude productive citizens from social entitlements. It concerns social benefits such as regressive family allowances, progressive school fees and child care fees, regressive reductions or even free access to social housing, public transport, cultural events, and the like. All such "social" programs each taken apart may have a reasonable justification. However the cumulative benefits of these social measures add up to an absurd social model under which compensation of labour has become negative after workers have paid for all their expenses and when the missed social benefits are all accounted.**
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> **And this is even more so when the value of leisure is taken into account. The trade-off between leisure and buying power is indeed the preponderating factor in the citizen's considerations whether to participate in the formal economy or not. Leisure does indeed not only provide the freedom to savour recreational activities or choose an enjoyable pastime. Above all it provides the opportunity for al types of lucrative activities, providing economic value to the unemployed from which active workers are in fact excluded. Activities like self-catering, childcare or old age care, home maintenance, repairs, and participation in black market activities all do provide a bunch of informal wealth exlusively to those enjoying leisure. The European social models were desighned to be equitable. no model however takes the eminent value of leisure into acount. As a consequence today's main source of inequality is not the unequal distribution of buying power, but the unequal distribution of leisure.**

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European social structures have indeed created the absurd legal conditions under which the net marginal value of work is only a fraction the marginal value of leisure, resulting in the unemployed being better off or have a better quality of life than their hard working colleagues. Such perversions in the social model mean in fact reverse solidarity and undermine the basic values our culture is based on. The unemployment trap is indeed the gravest perversion of the European social system. Rather than preventing exclusion and promoting self-reliance, this welfare excess provides incentives to leave the productive sector. Eventually it leads to reduced creation of wealth, setting in motion a negative spiral of welfare addiction, dependency and decreasing numbers of jobs on offer.

Fighting such perversions and abuses of the social system must be one of Europes's prime objectives. It can be realised through increasing difference between lowest net wages and unemployment benefits. It can be realised either through lowering average taxation, decreasing progressiveness of the tax structure, or any combination of both. The impact on budgets would be gigantic. Not only could it reduce the huge expenses of unemployment benefits, but above all increase state revenues from the increased activity. The study of net family budgets of both employed and unemployed is the first step in recognising the unemployment trap. The co-existence of both high levels of unemployment and high levels of unanswered jobs on offer is the early symptom of a developing unemployment trap.

Directing Public funds at programs with high social value.

So far we looked at public counterproductive public activities. A number of other public programs do provide positive social value, however the costs exceed the benefit for society. There are tree major causes why the cost of many public programs exceeds the benefits for society.

1. Programs benefiting the whole Population.

The greatest overall benefit of public programs obviously is achieved when all members of society benefit, and not just a few of its members. The smaller the group of beneficiaries the lesser overall productivity of the initiative. The most obvious unproductive use of public funds appears when only those who designed the program benefit. It is the case of private abuse of public funds, corruption in favour of individuals or groups, or when politicians "buy" their votes through programs benefiting the voters of their own constituencies only. Also when programs are developed under insistence of lobbyists or pressure groups. All such programs do not benefit society as a whole, and are likely to yield low overall social benefit. As a major policy conclusion one can reasonably state that neither lobbyists nor pressure groups do represent the society as a whole. Only the parliament is elected, and represents all classes of the population, and should be the sole responsible in the decision making process on public policy in the interest of all.

2. Programs with high social Benefit

Loss of public value also occurs when funds are allocated be it for the benefit of all, but in projects with low added value. One can think of luxury expenditures such as sumptuous offices, monuments, or obsessive concerns over degradation of nature, or obsessive preference of the authorities for particular programs. The problem with such programs are the opportunity costs; this is the loss resulting from funds not being used for the most priority and most appropriate use, which provide the most added value to society. A peculiar cause of waste of public value occurs at the end of fiscal years. Often budgets were not spent during the fiscal year, and departments have to invent the most useless uses for the surpluses, if they want to avoid the loss of the surplus for their departments. Hence the necessity for transportability and the use of balance sheets in public accounting.

3. Risk management: Adjusting Resources to Risks Relevancy.

Policy makers generally are obsessed with risks, even if the statistical chances of the risk happening is negligible. The problem is one of concept. Policy makers most often are blamed for not having avoided an event from happening. Politicians are seldom blamed for incurring excessive costs for avoiding even the most unthinkable of risks. The political problem originates in human mind assessing risks emotionally in stead of logically. It is for the same reason that lotteries are successful in spite of lotteries delivering only 50 cents value for every Euro spent. As a consequence policy makers tend to avoid their responsibility and choose for the zero-risk policy: doing everything to avoid even the most remote coincidence from happening.

Unfortunately there is no such thing as the utopia of a risk free life. The only way to avoid all risk on a traffic accident is to stay at home. The only way to avoid every risk of food poisoning is to stop eating. However stopping eating will cause death by starvation, and when nobody moves the economy will just come to a standstill. So in real life the strategy of having risk reduced to zero is an unworkable strategy. Instead of chasing the utopia of risk-free life, public risk management should be assessing risk rationally and develop strategies to manage the risks down to acceptable levels. Besides the strategy of avoiding risks from happening, and reducing their consequences, also accepting reasonable levels of risks must be considered. The cost of avoidance must rationally be weighed against their statistical chance from happening. Particularly emotional exuberance in risk avoidance must be averted, and a rational priority process must be followed whereby the risks with the greatest loss and the greatest probability of occurring are handled first, and risks with lower probability of occurrence and lower loss are handled later.

Very typical are excessive emotional concerns over traffic safety, obsessive worries over food safety. Often these emotional concerns are absorbing excessive resources or causing excessive regulation and incurring excessive costs to industry and to the consumer, and distorting the allocative efficiency, as resources could have been much better spent in creating added value elsewhere.

Management at the lowest level of Administration.

The efficiency of the public sector could very substantially be upgraded if the principles of subsidiarity were consequently applied. A first principle of subsidiarity holds that government should undertake only those initiatives, which exceed the capacity of individuals or private groups. The principle is based upon the autonomy and dignity of the human individual, which holds that humans by their very nature are social beings gifted with empathy, rationality and responsibility and therefore capable of responsible social behaviour.

Subsidiarity therefore includes that matters ought to be handled by the smallest or, the lowest competent level of authority. Central authority should only have a subsidiary function, performing only those tasks, which cannot be performed effectively at a more immediate or local level. Furthermore subsidiarity emphasises the importance of small communities and institutions, such as the family, church, and informal associations, as mediating structures, linking the individual to society as a whole.

The reason for the efficiency of organisations structured on the principles of subsidiarity is straightforward. The closer the level of authority to its citizens, the sooner and the better the needs and opportunities can be assessed, and the better programs and regulations can be targeted at the special needs of this smaller community. Subgroups of larger communities may have different interests, and the more different interests in a community, the larger the chance of conflict of interest. General rules which may be good for part of the community may be bad another.

The question of subsidiarity is particularly acute in the context of the European Integration. In recent decades Europeans have witnessed ever more powers going to the central European Authority, generally without them having their democratic say in the process. Prof. Vaubel heavily criticises this move, which obviously is opposite to subsidiarity. For Vaubel the more political integration in Europe, the more advantages of the internal market come under pressure. Political centralisation promotes in deed the need to more regulation. And too many rules reduce the efficiency of market forces. Just like David Hume or Emmanuel Kant, Vaubel thinks that competition between, small entities has contributed largely to the success in Europe the past 500 years. That in contrast to China or India or the Ottomanian Empire, where centralisation and a lack of freedom went paired with a weak economic development.

The Separation of Economy and State

The separation from church and state was one of the greatest achievements of the French revolution. It freed government from Church interference in state affairs, and gave birth to the greatest progress in history. The secular state indeed does not only protect religious institutions from interference by the state, but public power is also protected from the interference by religious institutions. So the tolerance is mutual. The main reason for restraining from each other's business is that both church and state have different responsibilities, and have different interests, methods and priorities. Society is the art of living and working together without having the same religion. Although the concept is quite recent in history, one cannot think of a modern state without it. Just as the separation of church and state liberated public policy from the inhibitions of religious dogma, and allowed for both the church and the state to deploy its own strategies of development, the separation of economy and state could deliver a similar bond forward. The effects would be beneficial for both the economy and the state. The reasons are essentially the same as for the separation from church and state: because responsibilities and priorities of both the economy and the state notably differ, and they both would flourish better if they could independently develop their own strategies of progress. Also because persons function best when they can live according to their own conscience, and when they are not hindered by regulatory interference. Thirdly and not in the least because markets rather than plans lead to the optimal use of resources.

Governments should leave people alone regarding their economic activities because we all benefit from everyone enjoying the freedom of enterprise. If one thinks of the wealth that could be delivered when economic enterprise were free from government control and regulation. Why not adopt a system in which people are free from government restrictions on entering into any business activity, entering into mutually beneficial transactions with others, accumulating unlimited amounts of wealth, and doing whatever they want with their own money, free from intervention by ambitious and unscrupulous politicians.

- ***The problem with interventionism is that it always gives preferential treatment of some sort for particular industries, sectors, organisations, or to particular consumers. By doing so it disfavours other firms, sectors or citizens. The result is distortionate allocation of resources.*** **Although each single state intervention may appear reasonably justified, favouritism disturbs the overall economical allocation of resources. The new situation always differs from what the economists describe as the optimal equilibrium, at which markets provide maximal overall wealth. While the intervention creates an illusion of advancement for parts of the system, the overall effect of distorted allocation of resources for the economy as a whole is that less overall added value is created than before the state intervention.**

- ***But intervention does not stop with just this one single shot. The disfavoured from the first intervention will need and will require remedial action.*** **Ever more new pressure groups of disfavoured will call for intervention after intervention in an accelerating rate, as progressively more sectors get into trouble from previous preferential treatments. This disorganises the allocation of scarce resources, progressively plunging the economy in a downward spiral of increasing dirigism and decreasing wealth.**

- ***But there is a third good reason why governments should restrain from interference: because the State interference causes the heaviest business risk there is, deterring investment.*** **The risk of governments interfering with a business operation or authorities changing the rules of the game during the writing-off period creates an investment hazard that makes enterprise into an unreasonable gamble. Unlike other hazards, the risk of government action is both unmeasurable and uninsurable. Nor the chance of happening, nor the size of the desaster can indeed be assessed, while government action can indeed be devestating as it can annihilate the profitability of an operation, and make any investment worthless just overnight.**

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1. Abolish all occupational-licensure laws.

In 1948 the United Nations have solemny proclaimed the right to work and to free choice of employment as a universal human right.[6] Occupational licensure-laws are per definition contrary to this fundamental right, as such laws subject the right to a chosen occupation to preliminary approval of a state authority; exactly what the UN declaration wanted to prevent. Licensure laws subject citizens to rather arbitrary conditions and individual approval of their projects. So 60 years after the solemn UN declaration it is time to abolish all remaining corporatism, being medieval remnants of an outdated guilds system.

Licensure laws do indeed not only conflict with human rights; the system of licensure is uneconomic. Not only does it create a totally superfluous administration and legal uncertainty, it also hinders the creation of new business and competition. Licences are an anti-competitive racket par excellence. Licensure laws interfere with the ability of people to enter into mutually beneficial trades with one another. Government regulations frustrate people's ability to do what they would do in the absence of the regulations. To the extent that government regulations interfere with people's ability to trade freely, the government is obstructing their ability to increase their own and others' economic well-being

2. Privatising what the private Sector can do better: Restoring belief in markets

When private firms find out that other companies offer better goods or services or at a lower price than they can produce it themselves they tend to outsource these goods and services. They tend to delegate non-core operations or jobs from internal production within a business to an external subcontractor that specialises in that operation. In doing so, costs are reduced, quality is improved or both. The benefits for productivity have been widely proven in business and industry, and there is no reason why the benefits should not apply to public management. Governments should restrain to what is generally accepted as their core business: Public safety and the maintenance of the rule of law. History has proven governments did an extremely poor job in the past in running airports, railways, telephone companies, steel plants, energy distribution, public television or in managing office buildings, health care, old age care etc. All these non-core business could be done much more efficiently by the private sector.

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[6] http://www.un.org/Overview/rights.html

3. Pruning Subsidies.

Another extremely counterproductive use of public funds is the use of subsidies as means of steering the economy. It concerns different types of measures destined at providing advantages to specific branches of industry, be it through direct financial subsidies to companies, import restrictions, or through subsidising the purchase of their products, or providing their services for free. The problem is that most subsidies disturb the allocation of scarce resources. Every Euro subsidy paid to bail out an unprofitable industry is ultimately paid by profitable sectors of industry. So the macro-economic result of subsidies is to shift resources from productive to less productive branches, and in the course' of the process making all kind of useless administrative expenses to control and manage the transfers.

4. Confining city Planning to its real Task.

City planning has in most European countries degenerated in huge, costly and mostly authoritarian administration restraining people and businesses with all kinds of generally obsolete restrictions. Excessively restrictive city planning incompatible with the human right to development has largely contributed to the slowdown of Europe's economy. Shortage of industrial terrain's and high prices for building plots for both industry and private housing, are direct consequences of intentionally over-restrictive planning. The exorbitant prices are empirical poof of the restrictive and destructive interference on the economy. The insane traffic congestion are also a direct consequence of restrictive planning, and daily convicts workers to the most stupefying, annoying and frustrating pass-times known to mankind, costing the economy billions of Euro's.

The prime victims of the artificial shortage of industrial terrain's and the consequential phenomenal prices are industries, who sooner or later have to calculate the price of their investments in the sales prices for their products. Less visible victims are the thousands of potential entrepreneurs who never start up due to the exorbitant starting capital needed. But particularly the citizens suffer from high house prices as the price of family houses is now absorbing the most of their lifetime savings. The sole beneficiaries of the restrictive planning are government agencies progressively having acquired the monopoly of new land development in most European countries. Thanks to their monopoly and their creation of a systematic artificial shortage they can charge whatever price they want. This monopolistic abuse is costing the economy billions of Euros and millions of jobs, and are all symptoms that the present planning fails.

City planning should restrict to its true task: evaluating future needs of the population and not reinventing them. Assessing investments needed to satisfy peoples' needs, and organise infrastructure in a way to avoid incompatibilities and mutual nuisance. Planners need not re-engineering people's preferences in an ambitious all-comprehensive plan to shape their fellow citizens' way of life. People need nobody telling them how and where they should live, they need no petty dictators prescribing them the sizes of their windows, the thickness of isolation, the inclination of their roofs. People know better than planners do what is good for them. Retailers know better than planners where their customers live and where is their centre of gravity. Industries can better than planners calculate their optimal location, where they can find personnel, raw materials and clients. Most of the costly administration of city planners and their city utopia experts are pure waste and nuisance. Reducing to the strict minimum can seriously upgrade productivity of Europe's economy.

5. Limiting Interference of Pressure Groups in consensus Models.

The separation of economy and State requires mutual respect for ones responsibilities. Just as in a secular society church restrains from interfering with state affairs, pressure groups as well as social partners should restrain from state affairs, and exactly for the same reasons. However important all these groups may be, just as the church, they do not represent society as a whole, have different responsibilities and priorities, and are not mandated by the population as a whole to act on their behalf. In the first place lobbying groups often plead for one-sided solutions, but also Europe's widespread consultation bodies in which employers and employees reach agreements over all major sectors of policy, and design public policy are at stake. They do so in the absence of taxpayers and representatives of the next generation and most design policies against their interest and without their consent. However useful in avoiding social conflict, this consensus model has resulted over the decades to inappropriate use of public funds, and to Europe's phenomenal debt. As a major policy conclusion one can reasonably state that neither lobbyists nor pressure groups represent the society as a whole. Only parliaments are elected, and represent all classes of the population, and should be the sole responsible in the final decision making process on public policy.

Human Resource Management in the Public Sector.

Introducing Incentives & Responsibility.

The efficiency of the public sector could also be upgraded very substantially if the public sector's staff would be motivated as in the private sector. The main reason for the de-motivation of the public servants is that their jobs are generally stripped to the bone of creativity and responsibility. Political nominations as well as the prevailing planning culture necessitate an extreme hierarchical structure of the public function. Consequently civil servants are confined to a lifetime job of executing detailed orders of their superiors. So civil servants generally feel treated by their superiors as idiots who are incapable of thinking, weighing and judging, and feel highly disrespected in the jobs they are doing.

Every organisation that treats its collaborators this way causes a tremendous waste of human resources. It does not only leave a huge source of human capacities unattended, but it is tremendously demotivating when one's capacity is reduced to just a job of executing orders. Extreme hierarchical structures as in the public function serve only one purpose: the concentration of maximal power in the hands of a few politicians. In their turn these politicians end up having to decide over so many things they do not even have the time to properly have some knowledge about it.

Excessive Hierarchical structures are organisational blunders as they fail to provide incentives and the opportunities to creativity to the collaborators. Introducing at least the basics of human resource management in the public function could most seriously increase its productivity, and convert a mentality of clerks into one of civil servants of the public interest.

Financially Sustainable Growth.

Green parties all over the world have seriously contributed to introducing the concept of sustainable development. Sustainable development has been defined by the UNDP as the process of developing in a way that the needs of the present generation are met, without compromising the ability of future generations to meet their own needs. So the basic idea behind sustainability is that one should leave a world to ones children that is at least as good a place to live in than one found it. Unfortunately green parties all over the world are concerned only about sustainability when it concerns environmental degradation and depletion of natural resources, never when it concerns the depletion of financial resources. Even more detrimental to future generation's prosperity is indeed trans-generational indebtedness.

Sustainability does not exclude progress. It only excludes overexploitation by the present generation at the expense of future generations. Environmental degradation, depletion of natural resources but also indebtedness and depletion of financial resources seriously endanger the ability of future generations to meet their own needs and their quality of life.

Stimulating Tax Competition between Governments

The last, but maybe by far the most effective way to upgrade the public sectors productivity performance would be stimulating tax competition between governments of different countries, and between local authorities. When private companies operate on a free market, they have to rival for winning customers. Continuously they have to develop better products, better services, and charge competitive prices. They have to develop better technologies to make their production more performing, and have to find better ways to distribute their goods and services more efficiently. This competition ultimately gives consumers greater selection of better products at lower prices and ultimately leads to the optimal allocation and use of resources.

European gvernments spend half of the fruit of their citizens labour without even giving a price quotation for their services. Public authorities would provide much better service if they would operate in a competitive environment. There is indeed absolutely no reason why the overwhelming benefits of competition between commercial companies would not apply to governments. Just as competition between private firms leads to better services for better prices, tax competition between governments - on three levels- would lead to the optimal use of taxpayer's money.

- Just as commercial enterprises enter in price competition, governments could rival with one another for attracting productive citizens and investment with their tax rates. Such tax rate competition would oblige governments to make the best use of available tax revenues and provide the taxpayer better value for money.

- Just as commercial enterprises compete with the quality of their products, governments could rival with one another with a better and lesser distorting tax mix, adding potential to the nation's prosperity growth.

- Just as commercial enterprises rival for finding new products, governments could rival with their fiscal creativity: By developing differentiated tax structures, differentiated tax bases, or even search totally new forms of financing budgets. Differentiated tax structures will interest different types of businesses and people, and attract different types of investment.

An excellent example of fiscal inventivity was given by the Belgian Government, when it introduced the "notional interest" deduction; a tax relief for the fictitious interest paid on own capital, which is likely to attract capital intensive investment to Belgium, and encourage industries to re-capitalise. Just as competition between private companies leads to greater selection of better products at lower prices and ultimately leads to the optimal allocation and use of resources, tax competition between governments could become the driving force to make governments competitive, creative and performing. And make them use taxpayer's money for the best advantage of all.

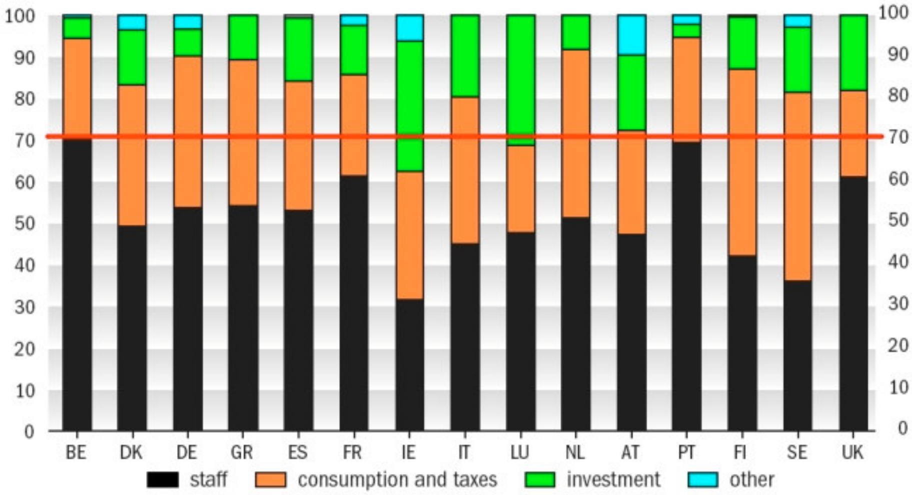
Tax Harmonisation: the Monopolistic Tax Abuse.

When governments see their people and businesses flee the local tax misery, these governments have two possibilities. Either they reduce the local tax misery, or they can try to persuade other governments, and export the tax misery abroad, so that escape is no longer possible. European governments seem to choose the latter solution. Just as monopolists always claim the merits of monopolism and point at the waste of competition, Europe's big governments are calling for tax harmonisation; just the opposite what Europe's economy needs. Governments call for tax harmonisation not for the benefit of citizens, but for the sake of protecting the status-quo, mainly to defend their wasteful and convenient way of managing the state budget: just increase taxes or borrowing whenever money fails.

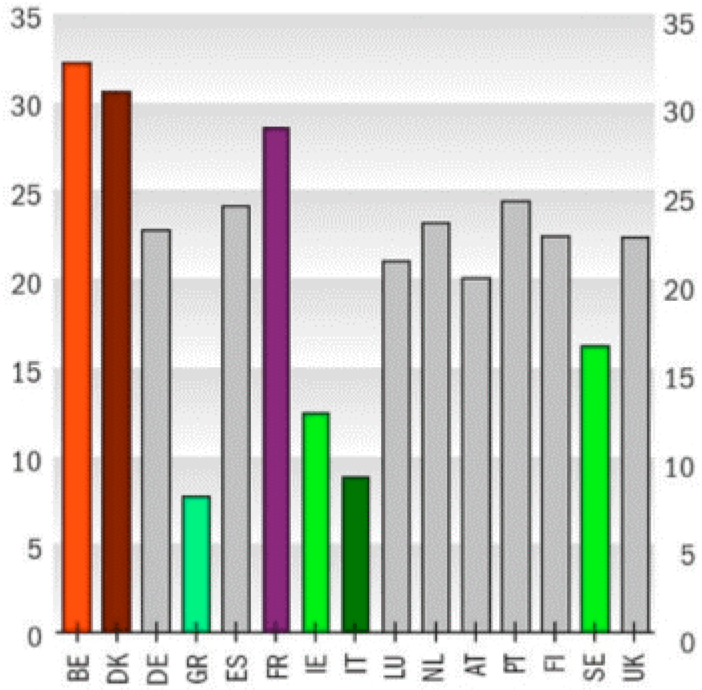
Europe’s high-tax and very-high-tax regimes in fact fear that the Irish success will motivate less greedy and more efficient governments to copy the Irish policies. Tax harmonisation is meant at preventing the Irish policies from spreading over Europe, and at imposing high-tax-policies on all EU-members through new EU-directives. High tax regimes hope to transform Europe into a continent where tax laws are all the same, and tax rates are equally high everywhere, so the tax payer could no longer have the choice between tax regimes. They dream of a huge high-tax Alcatraz from which escape is no longer possible. This would be an economic disaster.

Fortunately EU-Treaties guarantee full autonomy in fiscal affairs to the member-states. So imposing tax harmonisation by majority rule would be an infringement on the existing treaties. Still tax harmonisation is introduced in the same sneaky way as the EU’s devastating savings directive was introduced. Step by step and through blackmail. First a tax-base harmonisation is proposed, and then a back-door harmonisation of tax rates. First for savings, then for business profits, then for private income. Despite the severity of Europe’s high-tax disaster Europe’s high-tax-regimes obviously still refuse to see the un-sustainability of their high-spending high-debt high-tax policies. These Keynesian policies have failed. Tax harmonisation is designed to hinder the flow of jobs and capital from high-tax countries to low-tax nations, and is contrary to liberalisation. It protects big governments from the discipline of market pressure, and will lead to higher taxes. This means less economic growth and reduced opportunity. Just as monopolists' profits maximisation leads to narrowing their sales markets, tax harmonisation leads to less prosperity and will considerably increase unemployment and poverty.

Composition of government expenditure on general public services of EU-15 countries, 2001 (percentage)[a]



Employees in public administration per 1.000 population, 2000



Source: OECD, ILO, NATO, European Sourcebook, US Sourcebook, AIV (SCP revision)

Final Conclusions: Europe's challenges
Gaining competitiveness in a globalizing Market Place With an aging Population

Europe's Stagnation: An Organized Man-Made Disaster

2004 and 2005 were years for the record books: the world economy grew at its fastest rate in almost three decades. Despite the favourable cyclical conditions and its huge potential, Europe's economy is in a deplorable state. While the world economy is booming at a growth rate of over 4%, Europe's growth is stagnating at an embellished 1.5%. Static or falling productivity, stagnant production, and appalling levels of unemployment are the salient factors. Germany's unemployment is above 5 million but could be as high as 6 million when the "hidden unemployed" are taken into account. These figures equal those of 1932, at the depths of the Great Depression and just before Hitler came to power. The reality of Europe's ailing economy is contrasting sharply with the inflated expectations promised at the launch of political projects such as monetary union or the Lisbon Agenda. Europe's 20 milion unempolyed are questioning what is so social about a social model that creates poor growth, unemployment, bureaucracy and abandonment of whole sectors of industry.

Present Tax Policies Unadapted For Globalization

Europe's gradual decline in competitiveness and growth already started in the 80's and coincided with the gradual growth of Europe's public sector to 50% of GDP and more, reaching a level where public spending was one third higher than OECD average and its major competitors such as the USA and Japan. Before globalization our main competitors had comparable social and cost structures. However the rapidly globalizing marketplace for goods and services is now exposing Europe's economy to a worldwide competition where competitors operate with little or no social burden. As globalisation is both unavoidable and rapid, restoring competitivness a priority. A second challange challange is Europe's aging and declining population. The increasing dependency ratio makes the present funding of the social security system unsustainable, and changes are urgent to avoid the oncoming disaster of social crisis.

The globalizing market place and the most serious demographic decline since black death ravaged the continent in the middle ages puts Europe before two simultaneous challenges: restoring competitiveness and restoring financial balances of its social security system. For restoring competitivity the options are both limited and evident: either Europe will have to halve its wage cost (by tax cuts), or double its productivity, or a combination of both. Either policy choices will be made orderly in the very near future or market forces will force them on us rather randomly.

Cutting down cost

Pruning the excesses of the welfare state such as the "unemployment-trap" could restore at least some incentives to participation and fighting the numerous abuses could restore justice. However both wage cuts and cuts in essential social protection are facing social resistance. Alternatives are:

- improve productivity of the social security system, reducing its overhead and operational costs
- alternative financing on consumption as an alternative to the present local production.

Increasing productivity

Europe being at the top of technical productivity in the productive sector, further gains can only be marginal. Major productivity gains can however be acheived through:

- increasing productivity of public sector. The ECB study on public sector productivity has showed the weak points for each of the European countries: for Belgium administration
- a shift from unproductive (public) sector to the productive sector.
- increasing wage productivity through a shift of social burden from direct taxation to consumption taxes
- increasing labour market participation

<u>Total approach: providing incentives for participation and entrepreneurship:</u>
Obviuously shrinkage scenarios such as serious cuts in Europe's social security system is politically unattainable and would cause social conflict and political unrest. Moreover such cuts can never provide the necassary halving of Europe's wage cost for making Europe competitive in the world markets. A more dynamic approach focussing on remotivation of the productive citizens.

Ireland has shown that growth stimulating by fundamental tax reform can restore both entrepreneurship and labour market participation. Measures like postponing the retirement age, without measures to improve job creation, only shift the problem from pension funds to unemployment funds . The fundamental causes of European desease of poor participation rates and low levels of entrepreneurship should be taccked: demotivation through excessive taxation. However increasing labour market participation through legislative mesures such as upshifting ritirement age cannot lead to final solutions. Such measures are cutbacks on social achievements, and basically a cure of the symptom only, and do not provide the connditions for creating productive jobs to absorb the higher participation and the raised labour offer.

The creation of new jobs, and the numbers of new starters can only be stimulated by improoving Europe's detrimental entrepreneurial climate. Lowering the tax burden, the regulation burden, and increasing risk premium as compared to the relative generosity of the easy and risk free alternatives. If one wants to cure Europe's disease of low participation rates one should tackle the cause which is nothing less than total demotivation due to the heavy tax burden.

In the empirical part of this investigation we described the huge differences in economic and social performances between European Countries. These found that differentials must be attributed to differences in public policy rather than micro-economic differences between businesses or behavioural differences of the citizens.

The multiple regression analysis in which the recent Barro-Armey findings were implemented,explaied for 87% of the growth differentials. We identified the seven Growth and Job Killers :

- **Excessive government**
- **Over-consumption and under-investment**
- **Inflation & easy money policy**
- **Interventionism with Misallocation of Resources**
- **Demotivation**
- **Welfare excesses**
- **Keynesian Economic Policy**

- **European governments are highly oversized**

In our analysis the evidence of a strong negative relationship between government spending and growth prospects was consistently confirmed with high significance in all 5 models. European authorities, particularly Belgium, take too large a share of the wealth creation. As a result the private sector lacks the resources to fully realize its potential wealth creation. Moreover excessive taxation needed for financing public expenditure has been demotivating over the last 20 years productive participation in the economy.

Simulations showed that slimming down public spending by 5% GDP could boost growth by as much as 3%, and that this supplementary growth could lead to an increase of tax receipts in absolute figures, providing the public finance for the wide range of Europe's social, ecological, and cultural public initiatives, as well as for the cost of ageing.

These empirical findings are all related to the demotivation of productive participation in the official economy because of the laming tax burdens as well as an unbalanced tax structure, penalising too much labour, saving, investment, and profit.

A change in taxation policy can effectively remedy these European illnesses of poor participation levels, short working hours, lack of entrepreneurship all resulting in poor wealth growth. Tax policies should be aimed at providing incentives to work, to save, to invest and to improve the entrepreneurial climate. Besides a drastic reduction of the overall tax burden a shift of the burden from labour, profits and savings to consumption taxes could also substantially boost growth.

Obviously Europe's plans to gradually raise taxes on savings to 35% by 2011 go into the wrong direction and will have the opposite effect of providing incentives to higher over-consumption at the expense of savings and investment expenditures. Also E.U. plans to federally over-ride member state tax reductions by setting minimal tax rates, would have the contrary effect of obstructing the recent trend towards pro-growth tax policies such initiated and democratically decided by some of the (new) member states.

<u>Europe's opportunities</u>

Europe's common market has been a huge achievement for the benefit for all participating nations. Europe's mistake would be sacrificing those achievements for the creation of a bureaucratic superstate similar to former Soviet Union. Over-centralised decision making imposing endless rules aimed at regulating every aspect of daily life has the net effect to stifle enterprise and squelch innovation. Europe has the greatest potentials in the world: The world's biggest single consumer market, excellent climate and infrastructure, high levels of education, exceptional industrial productivity, good labour ethic, "fair business" morality, and not in the least the enormous potential provided by the opening of the iron curtain. For the first time since two generations Central European neighbours have acquired freedom and the long awaited opportunities to self determination and self realisation.

The reality is that the productive sector can no longer bear the burden of the unproductive government overhead. Ever more workers and businessmen face difficulties in paying the bills. The reality is that the productive sector is tired of expensive technocrats telling them how to bureaucratise its work. Managers are tired of technocrats hindering them at their task of producing wealth. The reality on Europe's work floor is that managers and personnel are demotivated and increasingly revolting against the persisting slavery of being confiscated over 50% of the fruit their labour, leaving them too little for their necessary innovations. Demotivation is the real cause of Europe's stagnation and the ultemate reason why ever more businesses flee Europe's tax misery. Belgian captains of industry selling out their crown jewels such as Quickstep, Domo, Balta are only the most visible sighn of the oncoming desaster. Of a much larger impact are the hundreds of smaller entrepreneurs scaling down or leaving in silence whilst innumbrable others never start up.

Europe is not working simply because it does not pay to work after the taxman has taken his share. Experimental cures of the symptoms do no longer help. It is time to tackle the true and ultimate cause of Europe's stagnation, which is nothing less than demotivation. It is time to lift bureaucratic and fiscal burdens. If not Europe will continue to lag behind ever further, ultimately resulting not only in economical, but also in cultural and moral decline.

<u>Ireland's Realistic Alternative shows the Way</u>

The fact that the Irish economy has been booming at an annual growth rate of over 5.6% for over 20 years proves that their alternative policy is successful and realistically possible within the actual European framework. Ireland has proven that low taxes and a flat tax structure is effective in both creating wealth and jobs and can provide the resources needed for Europe's wide range of cultural, environmental and social initiatives, as well as for the costs of ageing.

The historical and scientific evidence in favour of a growth enhancing strategy such as the Irish is overwhelming. Policies stimulating participation and production have simply worked everywhere where they were applied. That was the case in the U.S. under Reagan, that was the case in Iceland under Oddson, this is the case in Ireland now, and even German's "Wirtschaftswunder" under Erhard was a model of a production stimulating policy characterised by robust tax cuts.

Ultimately, such strategy is based on the simplest economical principle: A family that spends more then it earns becomes poor. That is a fact households and that is a fact for nations. A country that produces more than it consumes becomes wealthy. If one wants wealth one should boost production and not consumption. The principle is in fact as simple is that.

Free Institute for Economic Research

Abstract

European countries have comparable states of industrial development, productivity, knowledge level and labour ethics. Yet economic performances differ notably. While economies like France and Belgium slowly progressed with 38% and 42% only from 1984 to 2002, Ireland's wealth grow at 4 times faster rate by no less than 167% over the same 18 year period. In barely half a generation Ireland evolved from the second poorest to the second richest country of Europe. The differences in new job creation are similar. The cause of these growth differences is found in different macro-economic public policy rather than in micro-economic differences between citizens and businesses.

PART 1 - *The Economics of Taxation*

In a first part of this paper, we discuss the newest developments in macro-economic theory and taxation policies. We have special attention for theory relative to optimising tax receipts by Laffer (1985) and the Barro-Armey theories (1990-1995) concerning optimising prosperity growth and income distribution. We compare the taxation policies in different social models, and have particular interest whether the Scandinavian model is suited for maximizing growth and creating new jobs.

PART 2 - *The Causes of Growth Differentials: Empirical Research*

In the second part we search for the causes of European growth differentials by means of multiple regression. The main conclusion is that two factors of the public policy mix cause weak growth performances: excessive taxation and a demotivating tax structure, on the one hand, and over consumption with a lack of savings and investment on the other hand. We conclude that the public sector in most European countries is far too large, leaving the private sector with too little recourse for it to achieve its potential wealth creation.

PART 3 - *Ireland versus Belgium : A Case Study*

In part three we make a case study and analyse performances of two countries with opposite public policies: Ireland's with low public spending and a flat tax structure and Belgium with high levels of public spending and a heavy direct tax burden. We analyse the effects on growth, budget, public debt, job creation and social expenditure. We conclude that only stimulation of the supply-side of the economy rescue Europe's generous social system and provide sustainable recourses for the challenges of its fast ageing population. This confirms the overwhelming importance of production and investment as the prime social objective.

Part 4 - *Loosing Overweight: A slimming Cure for fat Governments.*

In part four, we look at possible scenarios on how to reduce the public spending as the most effective way to restore dynamism and growth. On the basis of simulations we investigate the possibilities and consequences of a budget-freeze in real terms. We analyse whether pruning bureaucracy and the parasitical sector can free resources and return our workforce to its real task of creating wealth, and ultimately restore efficiency and competitivity of both private and public sector.

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