THINK ABOUT IT

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Troubled economies and turbulent finance worldwide have produced volumes of comments and suggestions, some new and some are revisited old ones. Numbers of them warrant second thoughts before being taken seriously. The following is a selected sample of those that may seem appealing but are dubious.

--Among the steps being recommended to help during the problems afflicting the euro are some to revise the charter of the European Central Bank (ECB). One suggestion, from an official of a national government, is that the voting power of each member nation be modified to reflect the credit rating of the country's bonds. The rationale is that those who live by the rules and have better ratings should have more influence on the ECB's operations.

The ratings would come from the major credit rating agencies whose integrity and perceptiveness in evaluating bonds contributed substantially to the international financial distress that began in 2008.

--Government revenues from taxation could be increased if tax rates are reduced. Lower rates will stimulate economic activity so significantly that the lower rates will generate higher revenues.

This idea, which has been repeated in various guises for at least 30 years, has been tried and has only resulted in decreased revenues. A variation of it, that claims that present tax rates on higher incomes should be reduced so that wealthy people will create more jobs, is also based on the same assumption, namely that tax rates are so high that it isn't worth the effort to earn a higher income. There is no evidence to support this. Moreover, it could equally be argued that the desire for wealth is so great that up to some limit, higher tax rates stimulate entrepreneurship in the drive to accumulate.

--Jobs for "our" workers have been taken by in-migrants so that a cure for unemployment is to stop the inflow or to send the newcomers back to their place of origin.

At the most basic level, this argument assumes that there is just so much work to be done so that if "A" has a job, there is one less for "B." In fact, it is the earnings of each job holder that, when spent, create the demand that provide jobs for others. This is a variation of a doctrine that permeated economic thought in the 19th Century that recurs whenever unemployment is a problem. It overlooks the source of the demand for labor, which is spending. Enlarged spending is what creates jobs.

--Advanced industrial societies cannot afford the pensions they have promised their employees. Current and future pensions must be reduced and the age of retirement raised, at least in keeping with the lengthening of the life span.

There are some factual bases for this. A relatively smaller population in the working age group would be pressed to continue supporting a relatively larger population of retirees, particularly in those countries that have difficulty collecting taxes. However, some of these countries are magnets for younger migrants. Allowing them entry and permitting them to work and pay taxes could counter the demographic imbalance that is at the root of some countries' problem.

--The availability of credit from banks is a key to stimulating economic activity. Making sure that banks have adequate resources from public grants and loans or by providing them with low cost funds enables them to lend, a key to creating prosperity.

There is no doubt that the unavailability of credit can stifle economic activity but current events show that merely giving banks the wherewithal to lend does not create new lending. Currently, many banks and international corporations have record levels of financial assets that are not being directed toward job generating activities. They claim it is because the future looks uncertain. Among the major uncertainties is the future level of demand, that is, spending. Financial assets sit idle in the absence of demand.

--Society's wealth is created in the private sector. Government spending is a diversion of resources from wealth-generating activities.

This is akin to contending that expenditures on such things as public education are not wealth producing. Similarly, it would be interesting to know if the person making such statements ever uses publicly provided streets and roads. A variation on this assertion contends that government employment is necessarily wasteful. It would be interesting to know who is called in case of a fire.

--Any annual government deficit greater than 3% is excessive and adversely affects the country's fiscal soundness.

If the reasonable assumption is made that a country's long term real economic growth is about 3%, this statement seems to be aiming at a situation in which sovereign debt and real national production grow at about the same pace. However, production does not grow at a constant pace. In any one year, it may grow more or less rapidly. Similarly, the circumstances and events facing a country vary, sometimes requiring substantial outlays. Applying what might be a reasonable long term standard to an annual budget is itself unreasonable. Moreover, the requirement to reduce deficits to achieve the standard promptly is most likely to lower economic activity, resulting in unemployment, distress and lower government revenues. In turn, expenditures need to be reduced due to the decline in receipts, a vicious cycle that further erodes fiscal soundness, not to mention public welfare. What is offered as a virtue becomes a wickedness.

--Trouble looms for a country when its ratio of sovereign debt to GDP becomes 1 or greater.

The seeming precision of this statement is misleading. It is based upon assumptions that may be warranted in one case but not in another. That is because the "burden" of a nation's debt depends on several factors. One, obviously, is the rate of interest a country has to pay when it borrows or re-finances its debt. If one can borrow at 2% and another at 7%, their situations are clearly different. Another is the location of the lenders. If a country's debt is held by its own citizens, interest payments are an internal transfer, leaving gross internal expenditure levels largely unaffected. However, if the debt payments go to external lenders, there may well be adverse effects on the domestic economy. Other complexities also exist, making it unreasonable to establish a numerical and uniform standard by which to judge what is a safe debt/GDP level.

In summary, the moral that all this suggests is: Just because something sounds plausible doesn't mean that it is believable.