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WELFARE SYSTEMS AND THEIR COMPLEXITY

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Abstract

In different periods, economists and policy-makers have focused their attention on various aspects of fiscal policies, such as the accumulation of public debt and the impact of taxes on growth, the impact of fiscal policies on aggregate demand and the ability to reduce the severity of recessions, as well as the effect that they might have on the incentives of economic operators and on economic efficiency. This paper considers another aspect, which has attracted relatively little attention so far – namely the impact that they may have on the complexity of government operations. The approach proposed in the article would elevate simplicity, on both the spending and the revenue side, to a major criterion that should drive economic policy. The benchmark cases of relatively simple policies are universal healthcare and education programs in Scandinavian and some other European countries. The representative examples of relatively complex arrangement provide numerous means-tested social programs such as the Medicaid in the USA. Tax expenditures are another case of relatively complex policies. Programs like these inevitably become more expensive with the passing of time. Problems of horizontal and vertical equity increase, and they may give rise to growing antagonism to the programs. To deal with these problems, new rules are often created, making the programs progressively more complex. The need for and the importance of simplicity has been largely ignored by economists and by most governments. It deserves a far more prominent place among the criteria that should guide the choice of policies.

Keywords: welfare systems, complexity, universal welfare programs, means-tested welfare programs, tax expenditures.

JEL: H20, H51, H52, H53, I00.

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Introduction

In different periods, economists and policy-makers have been guided, in their fiscal policies actions or in their recommendations, by particular ideologies, and they have been influenced by perceived constraints. During the pre-Keynesian period, a period that, rightly or wrongly, has been defined as *laissez faire,* economists and policy-makers worried about the accumulation of public debt and about the impact that high taxes might have on growth[1].

The Keynesian Revolution changed that focus, and, for several decades, fiscal policy came to be assessed and analyzed mainly for its impact on aggregate *demand,* and for its ability to prevent, or reduce the severity of, recessions. The *supply-side revolution* of the late 1970s and 1980s once again redirected the focus, and many economists started assessing fiscal policies for the impact that they might have on the *incentives* of economic operators and on *economic efficiency.* The short-run, macro-economic, impact of fiscal policy was de-emphasized, and the old Say's Law (that stated that the supply creates its own demand), was, to some extent, resuscitated and given new life.

An aspect of policies that so far has attracted relatively little attention is the impact that they may have on the *complexity* of government operations, and complexity can have serious consequences [Tanzi, 2007; 2017; 2018a]. However, the full impact of complexity may be felt mainly in the long run, and economists and policy-makers tend to pay relatively little attention to the long run. They continue to follow, and occasionally cite, the Keynesian dictum that "in the long run we are all dead". So why bother about the long run? One problem is that, when the operations of governments become complex, their effects become less predictable. Complexity may also allow some individuals to take advantage of it, at society's cost.

The author of this paper started to worry about the impact of complexity on policies, and on its consequences for the economy, some years ago, before the 2007–2008 financial crisis. At that time, he speculated that complexity in the financial market might lead to a financial crisis, as it did [Tanzi, 2007. P. 239–241]. The present paper is an extension of this line of research on the role of complexity. For further and more recent discussions of complexity and of its consequences, see [Tanzi, 2011; 2013; 2017; 2018a].

1. Social Policies and Their Characteristics

At the time when countries were assumed to follow, or were following, a laissez faire ideology, until the Great Depression, the main social protection for individuals or for families facing economic difficulties had come from other members of extended families, and from mutual assistance

[1] See, for examples or discussions: [Leroy-Beaulieu, 1888; Smith, 1978]; Tanzi V. Pleasant Dreams or Nightmares in Public Debt Scenarios. Ifo Schnelldienst, Ifo Institute, 9/2016. May 2016. https://www.cesifo-group.de/DocDL/sd-2016-09-tanzi-abschied-sinn-2016-05-12.pdf.

societies and charitable institutions. Especially when individuals lived in closely knit and largely rural communities, extended families, charities, mutually assistance societies and parishes had had detailed and generally correct information on the economic conditions of individuals and families within their communities. At that time there were no "entitlements" to the assistance received. It was clearly provided and seen as a form of "charity".

In the situation that prevailed at that time, there could not have been significant "poverty traps", even though laziness, on the part of some individuals within families, might occasionally have made some members depend, more than they should have, on other family members. There could be, however, what could be called "location traps", because the assistance was no longer available when that person moved away from the extended family and the community.

This must have been a growing problem during the Industrial Revolution, when many workers were forced to move away from their communities and their families to go to work for distant industrial enterprises. When the workers lost their jobs, and/or became ill in the new places of work, they were often on their own, without support. This consideration must have discouraged some (less enterprising and more risk-adverse) individuals from moving to the distant places where jobs, or better paying jobs, were available. It is a well-supported fact that many of those who migrate are, often, more enterprising and more risk-taking individuals than those who do not.

During the later years of the Industrial Revolution, especially toward the end of the 19th and the beginning of the 20th century, some limited forms of (non-religious) social assistance, to support individuals in need, started to come into existence, through workers' confraternities and mutual assistance societies; through the actions of some paternalistic employers; and also, slowly, through newly created forms of government-sponsored assistance ([Tanzi, 2011], chapters 2 and 3).

When governments first started intervening as, for example, they did in Germany with the Bismarck's reforms, they did it mostly through regulations rather than through public spending. They did it with regulations related to the safety of the working places; with those that established the maximum working hours, or the age when children could work; with those requiring workers and/or their employers to buy some insurances for illnesses, for loss of life, for accidents, for (temporary) unemployment, and for retirement.

In these cases, the government played a mostly supervisory role. It was a "bureaucratic" rather than a "spending" role. The more efficient was a country's bureaucracy, the more useful was the bureaucratic role [Weber, 1958; Fogel, 2000]. Toward the turn of the 19th century, the bureaucracies of several countries were becoming more efficient and more capable than they had been in the past. This form of assistance required little public spending beyond that needed to pay the salaries of the more numerous and better educated public employees. Therefore, taxes could remain and remained low.

The above form of assistance was, first and generally, directed towards the needs of "workers", rather than those of "citizens". It was initially directed towards specific categories of workers (miners, sailors etc.), and specific industries. When the income distribution became a concern for governments, especially toward the beginning of the 20th century, a concern that stretched beyond the conditions of just "workers", there were pressures to redirect social assistance to include citizens in need, and "citizens" were not always "workers". This change started leading to higher government spending, and to the need for higher tax revenue.

Because of the Industrial Revolution, by that time the economic structure of several advanced countries had changed significantly. It included a growing number of large enterprises that concentrated, in a few places, the production of large output, sales and the generation of incomes. As a consequence, taxes could be raised more easily than in societies that had been mostly rural, and where informality had prevailed. Putting it differently, the *ecology of tax systems* had become more friendly to mass taxes (income and general sales taxes), making it easier for governments to collect higher tax revenue [Tanzi, 2018b].

Not by coincidence, this was also the time when the USA and other countries were introducing, or making greater use of, income taxes. In the USA the income tax was introduced in 1913. In all advanced countries these taxes would in time become the main sources of future public revenue, until the arrival, first in France in the 1950s, of the value added tax, which would become the main competitor of the income tax in generating revenue.

An additional factor that may merit mention is that, by the time when the industrial revolution had advanced enough to make possible for governments to collect high taxes and to deal *collectively* with some risks faced by citizens, the *political* structure of countries had also changed. By that time the proportion of those who had the right to vote had increased from a few percent of the adult (male) population to close to everyone. A more democratic country, especially one with female voters, tends to demand more socially oriented policies.

A simple spending policy option that governments could have adopted at that time would have been to use part of the higher taxes collected to provide a minimum ("vital") income for every citizen [Tanzi, 2006; Tanzi, 2018a]. This would have helped families with lower incomes to buy basic goods and services, and would have increased their economic security. Variations of this option have recently been attracting attention in several countries (Italy, Switzerland, Finland, and others). A *minimum vital income,* paid by the government to everyone, would have made the income distribution less uneven, because the citizens with the lowest incomes would have experienced the largest percentage increase in their purchasing power, while they would have paid less taxes. This policy would have interfered little with the work of the market, especially if the taxes collected had been broad-based taxes.

In this policy option, there would have been no need, on the part of governments, to decide who would receive the vital income, because *everyone,* rich and poor, would receive it. A higher tax burden than had existed previously would be needed, to make the payments to the citizens at a level that would have made a significant difference for them. The only information needed to distribute the vital income to the citizens would have been an accurate list of the living citizens. And the only decision to make would have been the size of the minimum income. That size would determine the tax level needed.

If the above option had been adopted when governments started intervening on a larger scale, it could have made it less necessary for them to become involved in many, specific, socially-oriented, and income-targeted programs, as they did. These latter programs required not only public spending but also specific information on some characteristics of the potential beneficiaries. However, the governments of most countries chose this alternative and most have continued to follow it. As a consequence, today, most countries have many and, in several cases, too many social programs. This approach has generally been endorsed by international organizations[2].

According to latest studies, in recent years there has been a growing reliance especially on income-targeted, or income tested, social benefit schemes[3].

The "vital income" alternative would have been simple and transparent, and it would have been accompanied by a minimum of disincentive effects, because one would receive the income whether or not he/she worked. The main difficulty would have arisen from political pressures, especially those coming from lower income groups, to raise the level of the minimum income, and those coming from higher income individuals and enterprises, to limit the increase in taxes.

A slightly more complex alternative to the above option would have been to limit the payment of the minimum, vital, income to only some age-defined categories of citizens, such as the "old" and/or the "young". For a proposal along these lines see [Tanzi, 2006]. This alternative option would still be administratively (but less politically) simple. It would leave some presumably "deserving" individuals without any protection. It would also create more political pressures on the part of groups of citizens. The reason is that the age at which one would be defined as "old", or as "young", to be entitled to the payment, would need to be determined politically. Individuals approaching the legally defined old age, or families with children above the chosen young age, would have an incentive to organize and to apply pressures on the government to lower the legal age to be considered "old", and to raise that for being "young".

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[2] [Gugushvili, Hirsch, 2014; World Development Report.., 1990]; see also: Notten G. How Poverty Indicators Confound Poverty Reductions Evaluations: The Targeting Performance of Income Transfers in Europe. Social Indicators Research, pp. 1-18. https://ruor.uottawa.ca/handle/10393/35036; Leventi Ch., Rastrigina O., Sutherland H. The Importance of Income-Tested Benefits in Good Times and Bad: Lessons from EU Countries. Paper presented at the 2018 IIPF Congress in Finland.

[3] Leventi Ch., Rastrigina O., Sutherland H. The Importance of Income-Tested Benefits in Good Times and Bad: Lessons from EU Countries. Paper presented at the 2018 IIPF congress in Finland.

Correct demographic information would be needed for all options that make social assistance depend on age. Furthermore, families with more children would be favored, creating an incentive to have more children. Decisions would be needed about the level of the assistance for the old and for the young, which might be different. Clearly, in this option, some additional complexity, and some additional incentives for rent seeking, would be created. Still, these problems could be considered to be relatively minor.

The next form of governmental intervention could be through government-financed social programs directed at meeting *specified risks or general needs* of the population. These programs might still be provided free, or at highly subsidized rates, to everyone, rich or poor. Three centuries ago, Adam Smith, in *The Wealth of Nations*, had advocated government-financed, *elementary* education. The justification was that a country with a literate citizenship tends to be a better and more efficient country. Today, most, though not all, countries *attempt* to provide free elementary education to everybody, even though, in some areas of countries, access to schools by children may be difficult, for logistic reasons. Also the quality of the free education offered may differ widely across the regions, or the areas of a country.

Beyond elementary education there is more controversy on whether higher education should be provided free to everyone. Some countries have made education free (or almost free) *at all levels*. Others have limited free education only for middle level schools, the school grades between elementary and university education.

Another form of *universal assistance,* for all citizens, is for health-related risks or needs. This assistance may be offered through government-financed and *universally accessible* health systems. The individuals who provide this assistance (doctors, nurses, technicians etc.) are, in effect, government employees. As the pamphlet that introduced the UK public health system in 1948 put it, "Everyone—rich or poor, woman or child—can use it or any part of it. There are no charges <...>.There are no insurance qualifications. But it is not charity. You are all paying for it <...> as taxpayers, and it will relieve your money worries in time of illness"[4]. Thus, universal financing and reduction of money worries were stressed.

Health care can be offered at different levels of quality and, of course, in different ways. The better is the level, the more expensive it often becomes. The more efficient is the way it is offered, the better are the results obtained in terms of better health. In modern times health services have become *very* differentiated in their quality, in the way they are offered, and in their costs. Statistical information indicates that spending more does not necessarily guarantee good results in terms of life expectancy or other indices.

The differentiation in quality and in results may arise from the cost and the availability of new and different drugs; from the quality of the hospitals

[4] Cited in Sarah Neville, The Bill of Health. *Financial Times, Life & Arts*, 2018, June 6/17, p. 1.

where some of the services are received; from the characteristics of some of the services received (say, private room versus shared room in hospitals); from the waiting time to get some services or surgery; from the attention paid on prevention; and so on. The conclusion is that public health can vary greatly in both quality and cost, and that the way it is provided needs to keep pace with changing circumstances and with developments in the medical field.

For societies with broadly identical personal incomes (that is with relatively even income distributions), and with an ethnically homogeneous population, a level of health services that is broadly, if not precisely, the same for everyone is more easily accepted by the citizens. However, as income distributions become more unequal, as they have in many countries in recent decades, and as the populations become less ethnically homogeneous, because of immigration, or more diverse in terms of age, due to growing life expectancy, the *uniformity* of services provided becomes increasingly less acceptable to individuals with higher incomes, who are often those who pay more taxes. In a market economy, these individuals will come to feel that their *economic* freedom is being unjustifiably limited by the universal public health program.

The way in which the health services should be offered depends on the age distribution of the population, on life expectancy, on habits (smokers versus non-smokers, obese versus non obese, those who exercise versus those who do not), and so on. Therefore, a public health system, or for that matter any universal system, cannot remain static over time. It will need to adjust continually to remain efficient. This adjustment is not easy or simple, especially as new drugs and new treatments may be continually developed by the pharmaceutical and health industry. Some new drugs or procedures may be very costly, but they may provide only marginal benefits compared to cheaper ones requiring the need for the application of social cost benefit evaluation for their use.

Several alternatives have been followed to deal with the problem created by wide income differentiation. One is to allow differentiated and better services that could be obtained against some extra payments, for those who want to use them. Examples of these better services would be: access to single, rather than shared, bedrooms in hospitals; faster access to surgery; access to more effective, but more expensive, drugs; and so on. Individual citizens can decide whether they want to pay the extra costs in order to get the better services; or to rely on the standard (less good) services offered free, or cheaply, from the public health system. It is easy to see how, in this alternative, administrative complications can easily arise. They would increase the complexity of the social assistance. Corruption is also likely to enter the picture on a larger scale than is normally the case.

Another alternative is that of allowing a parallel, private, health system to come into existence, next to the public one. In this case the public health system, with its shortcomings or limitations, would remain free or highly subsidized to all those who want to use it, while those with higher incomes would have the option, for specific health needs, to rely on the private alternative, for which they would pay the full cost.

One problem likely to arise with the above alternative is that the best doctors may tend to choose the private sector, thus reducing the value and the attractiveness of the free health system. This is more likely to happen when salaries in the public sector are kept low. Because the public health systems would be less used by those with higher incomes, they would have less of an incentive to politically support them, and to pay the taxes that cover their costs. Additionally, if controls are not effective, some doctors may end up working in both systems. The end result is: a reduction, over time, of the political appeal of the universal health systems; more complexity; and more corruption, as the experiences of some countries seem to indicate.

Still, another alternative is that followed by countries in which health services continue to be offered by the private sector but the government provides some, pre-determined, subsidies, through cost sharing, to all the citizens for specific services, when they use the private health services. In this alternative, regulations and controls over the private providers become important to limit abuse. The citizens can have the option to choose the private providers. Corrupt practices may also become a problem.

A country that introduced: (a) a minimum (vital) income for everyone, or a social pension for everyone reaching a given, but adjustable age, to reflect increasing life expectancy; (b) a free educational system, at all educational levels; and (c) a free health system, able to adjust, to take into account changing needs and progress in the availability of drugs and procedures, would increase the financial security for its citizens. It would also increase the economic opportunities for those at the lower end of the income distribution. This approach would inevitably require higher public spending and, therefore, higher tax levels. Some countries (Scandinavian countries and a few others) have been willing to pay this higher tax price. Others, and especially the USA and some other Anglo-Saxon, countries, have not. However, as indicated earlier, the trend in recent years has been to rely more on income targeted benefit programs.

2. On Means-Tested Social Programs

Another alternative that some countries have found attractive is to rely on a *private* health system as the normal system, but to create a parallel, free, or highly subsidized, *public* assistance system for individuals who, through *means testing,* can demonstrate that they do not have the financial means to pay, out of their pockets, for private health services. This is essentially the Medicaid System that exists in the United States. In this option, rules must be created to determine who can get access to the subsidies, and also to determine the share of the health costs borne by the users. Reported incomes become crucial inputs.

In the 20th century, when governments started to play a more significant role in social assistance, some countries, especially the USA and others, mostly Anglo Saxon countries, chose the "means-tested approach" to determine access to several public programs. Various considerations influenced that decision. One was antagonism to higher taxes. Another was the view that free access to government services might create "dependency" on the programs by some citizens. This might make the citizens lazy and less enterprising (while raising the tax level and reducing the economic liberty of others). Still, another was the moralistic view that only "deserving individuals", those truly unable to help themselves, ought to receive social assistance. These considerations led these governments to rely mainly on "means-tested" programs.

It should be stressed that *some* means-tested programs (for example access to public housing) exist in many countries. However, these means-tested programs seem to be more common and more dominant in Anglo Saxon countries than in others. In these and in an increasing number of European countries it was believed that free and flexible markets made it possible for most individuals to earn an income, thus allowing them to buy basic necessities directly from the market. Also austerity measures have intensified the search for what were believed to be cheaper social assistance options.

Conservative economists, especially members of the Austrian School, continued to believe in the power of the free market, even during the Great Depression. They blamed the 1930s Great Depression on inflexible wages and on misguided government interventions, and continued to resist the introductions of social policies, such as those that were introduced in the United States, by Franklin D. Roosevelt's New Deal in the 1930s. [Schlesinger, 1959; Stein, 1967; Mises, 1957; Wapshott, 2011].

The experience over the years of the USA and several European countries, with "means-tested programs", indicates that, with the passing of time, it becomes increasingly difficult for governments to limit access to the services provided by the subsidized programs *at the levels initially established*. As time passes, pressures build up to widen access, thus increasing the cost of the services, or lowering their quality. The definition of a "deserving individual" gets adjusted and becomes less restrictive. This has been shown by the US experience with Medicaid, with Food Stamps, with Disability Pensions, and with some other, means-tested, programs. It may also be surprising to learn that, in the USA, there are now about 80 such Federal means-tested, programs, in addition to others offered at the state level.

In most cases, the number of those who can access the programs increased over the years, and so did the costs[5]. The cost of means-tested US

[5] Growth in Means-Tested Programs and Tax Credits for Low-Income Households. Congressional Budget Office, 2013, February. https://www.cbo.gov/publication/43934.

Federal programs has increased from 1.2 percent of GDP, when President Johnson began the War on Poverty in 1966, to about 6 percent of GDP at present. To these costs one must add that of Medicare, which, strictly, is not a means-tested program but, presumably, a funded program for workers and their spouses. Recent estimates indicate that this program will run out of money within a few years.

The total cost of health services (public plus private) in the USA has risen to reach almost twice that in several other advanced countries. The cost of Medicaid alone (the means-tested public program) is now close to that of some universally accessible public health services in other countries. Unfortunately the results, in terms of life expectancy, cancer mortality, and other aspects of health, are far from what one would have expected or hoped for, given the US high level of spending.

A recent survey by Bloomberg ranked the US health service at the 34th place in the world in terms of life expectancy (which is influenced by factors other than the quality and the accessibility of the health system). It should be mentioned that there are *counties* in rich US *states* that rank with the best *countries* in the world in terms of life expectancy results. And there are *counties* in poorer US *states* that rank with the poorest and the least developed countries in the world. The provision of equal health services for all US citizens, clearly, has not been an objective of the US society.

Obesity, opium addiction, suicides, exposure to high pollution, accidents, death by use of guns, and other factors contribute to lowering life expectancy in the USA, as does the impact of smoking in most countries. Some of these problems are more serious among lower-income and less educated groups. This indicates that the educational role of the government, as compared with the curative role, in promoting better health has not been as effective as it could have been.

The results for the health systems are duplicated in the US educational systems and in those of some other countries. Some countries have made free access to broadly equal educational services, *at all levels,* a social objective. This objective is more easily achieved when everyone can go to equally good, and publicly financed, schools, *at all educational levels*. As mentioned, some countries provide free schools only at lower educational levels (elementary schools and middle schools).

In some federal countries (including the USA), the free schools are financed by local governments. The result is that poorer areas, where local governments have lower financial means, tend to have poorer and at times much poorer schools. In the USA, the differences in the quality of the school systems are likely to be as wide as those in the health system. The richest areas have some of the best schools in the world, while some of the poor areas have some of the worst. This makes equality of opportunities, among those who attend the different schools, very different.

Countries that rely on means-tested public programs must decide not only on the level of resources allocated to these programs but also on the criteria and on the rules to be adopted to determine who will get access to them. Decisions must be made on the criteria, on the laws, and on the regulations enacted, to determine the criteria to be satisfied by those allowed to use the programs. And some public employees must be charged with the task of applying those criteria, efficiently and fairly.

The above arrangements automatically transform the whole society into a kind of potentially accessible "common" for sub-groups. The whole society becomes a potential public resource (a classic "common"), from which, using their political power, some sub-groups can extract benefits for them, benefits that are denied to others, while shifting the costs to the whole society. This arrangement creates a situation whereby it becomes rational behavior, on the part of sub-groups that can establish some claim, to press for access to the "common". These groups will pressure governments to make easier for them to access the socially funded programs and to make the programs more generous.

The attempts to enlarge accessibility can come from different directions: (a) political pressures on policy-makers, that can lead to an enlargement of the "deserving" population (the poor, the disabled, the old etc.); (b) pressures on the bureaucracies to interpret the rules more flexibly; (c) acts of corruption, on the part of both those who apply the rules and those who try to use the programs. The latter has been a common problem in several countries, in defining when one should be considered "disabled" or "poor", to be entitled to disability pensions, or to have access to "food stamps", to "public housing", and to other poverty-related or income-adjusted benefits. In some countries, fees for some services (say, access to higher education) are determined by family incomes, a system that encourages families to underreport income to the tax authorities.

Inevitably, with the passing of time, the programs become more expensive and, in some sense, less legitimate. Problems of horizontal and vertical equity increase, and they may give rise to growing antagonism to the programs by those who pay the taxes but are excluded from them. To deal with these problems, new rules are often created, making the programs progressively more complex, and complexity facilitates acts of corruption, making even more difficult the task of monitoring the programs.

3. Tax Systems as Welfare Tools

A development parallel to the one described above for social programs has often occurred on the tax side, and for similar reasons. Countries that depend on means-tested programs have also relied more, than countries that use universal programs, on their tax systems, to achieve an increasing number of social objectives, beyond the obvious one of generating public revenue.

Various kinds of "tax expenditures" (a concept introduced in the USA in the 1960s), "tax incentives", "special tax treatments", and similar ones have been introduced in the tax systems to promote particular social goals. This aspect has attracted little attention, the assumption being that what happens on the tax side is unrelated to what happens on the expenditure side.

These social goals promoted through the tax system include: (a) encouraging home ownership, (b) getting an education, (c) paying for health spending (d) giving money to charities and to educational or research activities, (e) financing retirement accounts, (f) encouraging work over leisure, and many others. In the United States there are now no less than 167 "tax expenditures" and many other kinds of special tax treatments all aimed at encouraging and supporting some activities. They were introduced to achieve particular social objectives, through the tax system, by individuals and enterprises, rather than through public spending.

The use of "tax expenditures" and other "special tax treatments", in the personal income tax, the corporate income tax, and in countries that have the value added tax, has created many *holes* in the tax systems, making the tax systems less neutral, less horizontally equitable, and less productive in terms of revenue. This has much increased *tax complexity*, with undesirable consequences, including growing tax evasion and other tax abuse, growing compliance costs for taxpayers, and growing antagonism to taxes on the part of the electorate. It may not be a coincidence that in the past 20 years there has not been any increase in tax levels in OECD countries.

For those who, for various reasons, cannot take advantage of the special tax preferences, the tax burden must go up in order to prevent a fall in the needed total revenue, unless, as for corporations and high income individuals, they have the political power to force the reduction in *their* tax rates, or to give them more legal access to the tax incentives. This has happened in the USA, in 2018, and in other countries, in recent decades.

This, in turn, leads to pressures on governments to make more use of debt financing. The latter has also been a common development in many countries over the years, and especially after 1980 [Capitalizing.., 2018; Tanzi, 2015]. It is interesting to note that the share of debt into GDP in several countries, and especially in the USA, increased after the 1980s, when more conservative governments were in charge[6].

Both the complexity of the means-tested programs and that of the tax systems tend to be cumulative processes, over time. As time passes complexity increases in both the spending and the tax side. Just consider the effect on complexity of the combination of 80 means-tested Federal programs, all with their special rules, 167 tax expenditures, and other complexity in the US tax system. That system now requires tens of thousands of pages of rules and regulations, creating a legal jungle for citizens. Something similar has

[6] Tanzi V. The Limits of Stabilization Policy. *Acta Oeconomica*, 2018, forthcoming.

taken place, especially in other Anglo Saxon countries, leading to growing antagonism to taxes.

Comparisons of the "universal" social programs and of the tax systems of Scandinavian countries with those of the "means tested", social programs and tax systems, especially in the USA and some Anglo Saxon countries, indicate the extent to which this process of advancing complexity has created particular problems, such as increasing populism and calls for tax reductions. As mentioned, this has happened especially, but not only, in the USA, where the total tax *level* has hardly changed in half a century and is well below that of most other advanced countries, and where public debt has increased significantly and has become a growing concern.

Concluding Remarks

In his classic and influential 1944 book, Friedrich A. Hayek argued that interference with the market by governments was a "Road to Serfdom". The reason that he gave was that once governments start on that road, they soon realize that they can acquire more power over the citizens by extending the economic areas under their control. He assumed that the governments have both the power and the interest to do so.

People who cite Hayek today often forget, or ignore, the important fact that he was writing mainly about "socialist" countries (countries such as Russia under Stalin that had adopted central planning), and about "fascist" countries (Germany under Hitler, Italy under Mussolini, Spain under Franco, and some others), when he wrote his book. He was not writing about countries with solid democratic traditions, presumably capable of preventing or constraining that behavior by their governments.

Hayek's general views, as can be determined by reading most of his writings, and not just his 1944 book, were far less conservative than some have interpreted them to be. For example, in *The Constitution of Liberty*, 1960, he called himself a "liberal" and explicitly rejected the notion that he was a "conservative". In other writings he assigned to the government several responsibilities that are not commonly associated with libertarian governments [Tanzi, 2015].

Libertarians have argued that high taxes and high public spending necessarily reduce the economic freedom of citizens and make countries' economies less dynamic. They also believe that "altruism", whether individual or collective, can lead to undesirable results, while "greed" might be considered a "return on [good] investment" [MacLean, 2017. P. 135].

To some extent, these and similar views have influenced conservative governments to choose lower tax levels and to rely on less expensive, "means-tested", programs to assist citizens, rather than on more expensive "universal" programs, which require higher tax revenue. The means-tested programs have been financed mainly by personal income taxes, the structure of which can be manipulated more easily, to pursue some objectives that could have been better pursued with higher spending. One of these objectives is simply to reduce the tax level. The governments have used various tax preferences within the income taxes to promote the consumption of some socially desirable goods, goods that Richard Musgrave [Musgrave, 1959] had called "merit" goods.

The objective of tax expenditures is to *influence* the economic choices of taxpayers, while, at the same time, *reducing* public spending and tax levels. (For an early empirical evidence of this approach by Anglo-Saxon and other countries see [Tanzi, 1968][7]). This approach tends to give less weight to broad, "social", or "community" goals and more attention to the preferences and the needs of particular individuals. The aim is to give more economic freedom to individual choices.

Countries that rely on "universal" programs have made much less use of tax expenditures in the income taxes and more use of broadly-based value added taxes and also of simpler income taxes (such as "dual income taxes") to raise significantly higher tax revenue, but to do so in a more neutral way.

Given the view attributed to Hayek, it may seem strange to observe that there are several countries (Scandinavian countries, and several other European countries) that, in spite of having very high levels of public spending and tax revenue, levels that exceed those of the USA and other Anglo Saxon countries by, at times, 15–20 percentage points of GDP, are vibrant democracies with economies that operate rather well. What is even more remarkable is that some of these countries rank among the best performers in the world in various important indices, including economic indices.

The Scandinavian countries rank at the top, or close to the top, in indices such as the 2017 Atlas of Happiness (United Nation World Happiness Report of 2017); the 2017 Legatum Prosperity Index; the 2017 International Tax Competitiveness Index of the US Tax Foundation; the 2018 Competitiveness Index of PwC and the World Bank Group; the 2017 Human Freedom Index of the Fraser Institute (that measures "personal, civil, and economic freedom"); the 2018 "Corruption Perception Index" of Transparency International; and in other relevant indices, such as unemployment rates and the proportion of the population in the work force.

These indices suggest that high tax and high spending levels may not necessarily be "a road to serfdom" or to "socialism", or even a road to economic stagnation. They may also suggest that the way in which taxes are collected, and the way in which public money is spent in social programs, may be as, or more, important than their shares in GDP. As long as criteria of efficiency and simplicity are satisfied on the spending side, and criteria of simplicity, equity, and efficiency are satisfied on the revenue side, the levels may be less important.

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[7] Republished in Spanish in *Economia financiera española*, MCMI, XIX 30. 1968

A few "universal" and well managed programs, (such as universal public health, universal education, at all levels, and, perhaps, programs that provide a "vital income" to all citizens, or, alternatively, social pensions to all those who reach a given age) can replace many of the existing means-tested programs, and can reduce many important financial risks and sources of uncertainty faced by citizens. This approach inevitably calls for higher tax revenue. However, it removes much of the complexity that has characterized tax systems and spending programs, in countries with means-tested programs. In the process it also removes some poverty traps.

Complexity and poverty traps may have more serious consequences when they are associated with "means-tested" government interventions. Broad-based taxes (income taxes that respect some criterion of vertical equity, and value added taxes that tax *all or much of* consumption), and those that focus on getting revenue as the overwhelming objective of taxation, can replace the very complex taxes which have become common in the USA and in other Anglo Saxon countries, including Australia and Canada. These complex taxes have been a commonly shared characteristic of countries with "means-tested" programs. This becomes evident, for example, from a comparison of the complexity of the tax system of the USA with that of the Scandinavian countries.

The approach suggested in this paper would elevate *simplicity,* on both the spending and the revenue side, to a major or, perhaps, *the* major, criterion, that should drive economic policy. The need for and the importance of simplicity has been largely ignored by economists and by most governments. It deserves a far more prominent place among the criteria that should guide the choice of policies.

When policies become complex, their results become less predictable and more likely to contribute to income inequality and corruption and to invite populism. And the latter can lead to bad policies, such as protectionism and others, as the recent experience in the USA and in some other countries is indicating [Tanzi, 2018a].

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