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# Can We Afford a Welfare State?

By N. Gregory Mankiw

In the reconciliation package now being debated in Washington, President Biden and many congressional Democrats aim to expand the size and scope of government substantially. Americans should be wary of their plans — not only because of the sizable budgetary cost but also because of the broader risks to economic prosperity.

The details of the ambitious $3.5 trillion social spending bill are still being discussed, so it is unclear what it will end up including. In many ways, it seems like a grab bag of initiatives assembled from the progressive wish list. And it may be bigger than it sounds: Reports suggest that some provisions will arbitrarily lapse before the end of the 10-year budget window to reduce the bill's ostensible size, even though lawmakers hope to extend those policies at a later date.

People of all ages are in line to get something: government-funded pre-K for 3- and 4-year-olds, expanded child credits for families with children, two years of tuition-free community college, increased Pell grants for other college students, enhanced health insurance subsidies, paid family and medical leave, and expansions in Medicare for older Americans. A recent Times headline aptly described the plan's coverage as "cradle to grave."

If there is a common theme, it is that when you need a helping hand, the government will be there for you. It aims to assist people who are struggling in our rough-and-tumble market economy. On its face, that instinct doesn't sound bad. Many Western European nations have more generous social safety nets than the United States. The Biden plan takes a big step in that direction.

Can the United States afford to embrace a larger welfare state? From a narrow budgetary standpoint, the answer is yes. But the policy also raises larger questions about American values and aspirations, and about what kind of nation we want to be.

The Biden administration has promised to pay for the entire plan with higher taxes on corporations and the very wealthy. But there's good reason to doubt that claim. Budget experts, such as Maya MacGuineas, president of the Committee for a Responsible Federal Budget, are skeptical that the government can raise enough tax revenue from the wealthy to finance Mr. Biden's ambitious agenda.

The United States could do what Western Europe does — impose higher taxes on everyone. Most countries use a value-added tax, a form of a national sales tax, to raise a lot of revenue efficiently. If Americans really want larger government, we will have to pay for it, and a VAT could be the best way.

The costs of an expanded welfare state, however, extend beyond those reported in the budget. There are also broader economic effects.

Arthur Okun, the former economic adviser to President Lyndon Johnson, addressed this timeless issue in his 1975 book, “Equality and Efficiency: The Big Tradeoff.” According to Mr. Okun, policymakers want to maximize the economic pie while slicing it equally. But these goals often conflict. As policymakers attempt to rectify the market’s outcome by equalizing the slices, the pie tends to shrink.

Mr. Okun explains the trade-off with a metaphor: Providing a social safety net is like using a leaky bucket to redistribute water among people with different amounts. While bringing water to the thirstiest may be noble, it is also costly as some water is lost in transit.

In the real world, this leakage occurs because higher taxes distort incentives and impede economic growth. And those taxes aren’t just the explicit ones that finance benefits such as public education or health care. They also include implicit taxes baked into the benefits themselves. If these benefits decline when your income rises, people are discouraged from working. This implicit tax distorts incentives just as explicit taxes do. That doesn’t mean there is no point in trying to help those in need, but it does require being mindful of the downsides of doing so.

Which brings us back to Western Europe. Compared with the United States, G.D.P. per person in 2019 was 14 percent lower in Germany, 24 percent lower in France and 26 percent lower in the United Kingdom.

Economists disagree about why European nations are less prosperous than the United States. But a leading hypothesis, advanced by Edward Prescott, a Nobel laureate, in 2003, is that Europeans work less than Americans because they face higher taxes to finance a more generous social safety net.

In other words, most European nations use that leaky bucket more than the United States does and experience greater leakage, resulting in lower incomes. By aiming for more compassionate economies, they have created less prosperous ones. Americans should be careful to avoid that fate.

Compassion is a virtue, but so is respect for those who are talented, hardworking and successful. Most Americans descended from immigrants, who left their homelands to find freedom and forge their own destinies. Because of this history, we are more individualistic than Europeans, and our policies rightly reflect that cultural difference.

That is not to say that the United States has already struck the right balance between compassion and prosperity. It is a continuing tragedy that children are more likely to live in poverty than the overall population. That’s why my favorite provision in the Biden plan is the expanded child credit, which would reduce childhood poverty. (I am also sympathetic to policies aimed at climate change, which is an entirely different problem. Sadly, the Biden plan misses the opportunity to embrace the best solution — a carbon tax.)

But the entire $3.5 trillion package is too big and too risky. The wiser course is to take more incremental steps rather than to try to remake the economy in one fell swoop.