

# ECONOLAND NEWS

Number 1

PAC Data Lab, Wesleyan University

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## Tax Policy Problems:

Attempts at stabilizing Econoland by manipulating tax rates do more harm than good! The simulation evidence demonstrates that given the limited state of current economic knowledge it may be best not to attempt to improve macro economic conditions by adjusting tax policy.

When *Group 3* (Team Number 3) lowered taxes the end result was a slight reduction in the level of the Economic Discomfort index. This may have provided immediate gratification for the President, but there was less growth in GDP. As a result, the Economic Policy Score was only 273 at the end of their tax experimentation, down from an EPScore of 393 when the tax rate was left unchanged – and this was after 53 attempts at modifying their policy decisions in a frenetic effort to improve performance. Further, low investment over the course of the experiment results in a lower capital

stock, reduced worker productivity, and a cutback in potential GDP.

The *Economist* group (Team 5) had an even worse experience. Although this team had done spectacularly well in manipulating the level of government spending, achieving maximum growth and purchasing power with an EPScore of 429, disaster struck when they cut the tax rate to 16%. Low taxes encouraged consumption spending, leading the Fed to raise interest rates and hold back on the money supply in an attempt to control inflation. The resulting decline in investment means that there was less investment in new plant and equipment, worker productivity (output per hour) slumped, and output did not grow as rapidly as it had with higher taxes. And the government debt has soared. As a result of this disastrous tax experiment, the EPScore of the *Economist* group is only 279, a decline of 150 points.

## Experiment #2 Tax Reform Experiment

Par EPScore: 445

Team	AVERAGES				FINAL QUARTER			REPLAY HISTORY	
Num	EPScore	Unemp%	CPI%	Discom%	Date	Govt	TaxR%	Modify	Restart
1	381	5.5	7.8	13.3	2004-3	473.0	19.4	5	0
3	273	4.8	7.4	12.1	2004-3	505.0	19.0	53	0
5	279	5.0	8.1	13.1	2004-4	481.0	16.0	0	0
6	261	5.0	8.0	13.1	2004-4	519.0	19.5	0	0

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Team	FINAL QUARTER								
Num	Intr%	MoneyS	MGR%	CPI	KapS	PotGDP	GDP	Uemp%	RealGdebt
1	10.3	1361	13.7	425.3	2218	2757	2757	2.5	1115
3	9.5	1317	14.0	415.8	2183	2753	2669	7.5	1144
5	13.6	1325	12.2	428.4	2131	2742	2622	6.6	1284
6	14.7	1314	11.3	427.0	2097	2729	2604	6.6	1237

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Monetary Policy Works — (see page 2)

## for better or for worse?

Two policy teams have completed experiment #3, with mixed results. Team Number 1 (Wesleyan) had more inflation and more unemployment as a result of their misguided attempts at improving the economy by fine tuning interest rates. In contrast, the Auto Pilot team, with a constant rate of growth of the money supply, was much more successful at stabilizing inflation. As a result of the wise decision of the Fed to pursue a neutral policy of constant

money growth, the EPScore soared from 261 when the central bank was “leaning against the wind” to 394! However, a monetarist professor at Econoland U has objected that Auto Pilots (Team 6) allowed the money supply to grow much too fast. With a slower rate of monetary growth there would have been less inflation, output and employment would have been more stable, and there would have been peace and prosperity for all.

### Experiment #3 Monetary Policy

Par EPScore: 455

Team		AVERAGES			FINAL QUARTER			REPLAY HISTORY	
Num	EPScore	Unemp%	CPI%	Discom%	Date	Govt	TaxR%	Modify	Restart
1	381	5.5	7.8	13.3	2004-3	473.0	19.3	15	0
6	394	5.6	5.7	11.3	2004-4	519.0	19.5	3	3

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| Team | FINAL QUARTER |        |      |       |      |        |      |       |           |
|------|---------------|--------|------|-------|------|--------|------|-------|-----------|
| Num  | Intr%         | MoneyS | MGR% | CPI   | KapS | PotGDP | GDP  | Uemp% | RealGdebt |
| 1    | 10.2          | 1365   | 13.6 | 425.3 | 2218 | 2757   | 2757 | 2.5   | 1114      |
| 6    | 11.1          | 1237   | 11.0 | 389.4 | 2049 | 2709   | 2709 | 3.5   | 1430      |