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Will the Budget Cut Deal Hurt the Economic Recovery?

Posted by **STEPHEN GANDEL** Tuesday, April 12, 2011 at 3:26 pm

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Most people seemed to agree that the narrowly avoided government shutdown would have hurt the economy. But the question is whether the budget deal struck to avert the shutdown will hurt the economy more than if Washington had just turned off the lights?

The budget deal struck by President Obama and John Boehner and other Republicans over the weekend will cut \$38.5 billion from government spending in the next year. Generally, when the government spends less that slows the economy, just like when consumers or companies spend less. That was after all the reason many people thought a government shutdown, which would have temporarily slashed government spending and furloughed 800,000 government workers, would have hurt the economy.

Thomas Lam, who follows the US for OSK-DMG Economics Group, says the budget deal could reduce real GDP growth by at least 0.4%. The unemployment rate, which recently stood at 8.8%, could end up anywhere from 0.2% to 0.4% higher than it would have been without the deal. And Lam is not alone. Nor is he the most worried. Diane Swonk, chief economist at Chicago-based Mesirov Financial, says negative impact of the budget deal could be more than double Lam's estimate or 0.9%. She now estimates that GDP will grow 3.3% in 2011, down from a pre-deal estimate of 4.2%.

But, strangely enough not everyone thinks the budget deal will hurt the economy. Mark Zandi, of Economy.com, for one, says the budget deal will have a minimal affect on U.S. growth. Some even say it could boost the economy and jobs. Here's why:

First of all, as Zandi points out, the economy is in better shape than it was a year ago. So perhaps some reduced amount of government spending won't be noticed as companies and individuals begin to spend more. Perhaps. But in looking for a bright side of the government cuts, the New York *Times* repeats this argument for why the budget cuts might boost the economy:

As the government spends less it borrows less, and companies can borrow more. As the government collects less money in taxes, companies may increase spending and investment. "This cut combined with other cuts in entitlement reform will give the economy and businesses and investors some positive news on the fiscal front in Washington," said Chris Edwards, director of tax policy studies at the *Cato Institute*, a libertarian think tank that favors even larger reductions in the federal spending.

My problem with that first paragraph is that companies don't have a borrowing problem. Remember, **IBM** was able to borrow at just 1% last year. Any large company that wants money has been able to get it and get it at historically low rates. Yes, there have been some small companies that have been unable to borrow. But that is because of a lack of credit. And the people who see upside from cutting government spending are making an interest rate argument not a credit argument.

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In the end, the question of whether the budget deal will hurt or help the government comes down to what you believe about our debt level. If you believe we are at some breaking point where we are about to hit some serious questions about whether we will be able to pay back all the government has borrowed, then yes the budget deal could boost growth by keeping interest rates low. If not, then this budget deal is likely to slow the recovery somewhat. How do we decide whether America is at the debt breaking point? Well that's the topic of [another blog post](#).

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As usual, the New York Times editors are clueless about economics:
"As the government spends less it borrows less, and companies can borrow more."
Ridiculous. Federal sales of T-securities do not in any way reduce the ability of companies to borrow. Bank lending is restricted only by bank capital, and bank purchases of T-securities do not reduce capital or lending funds by even one cent.

"As the government collects less money in taxes, companies may increase spending and investment."
True, but what has this to do with reduced federal spending? There is zero connection between federal deficits and federal taxes. In fact, additional federal spending increases the ability of companies to spend and invest.

Rodger Malcolm Mitchell
Rodger Malcolm...

April 13, 2011
at 12:23 am
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Egypt's Major-General MOHAMMED EL-KHATIB, after Egypt's former president, Hosni Mubarak, and his sons were detained pending investigations into accusations of corruption and abuse of authority

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