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## US spending cuts

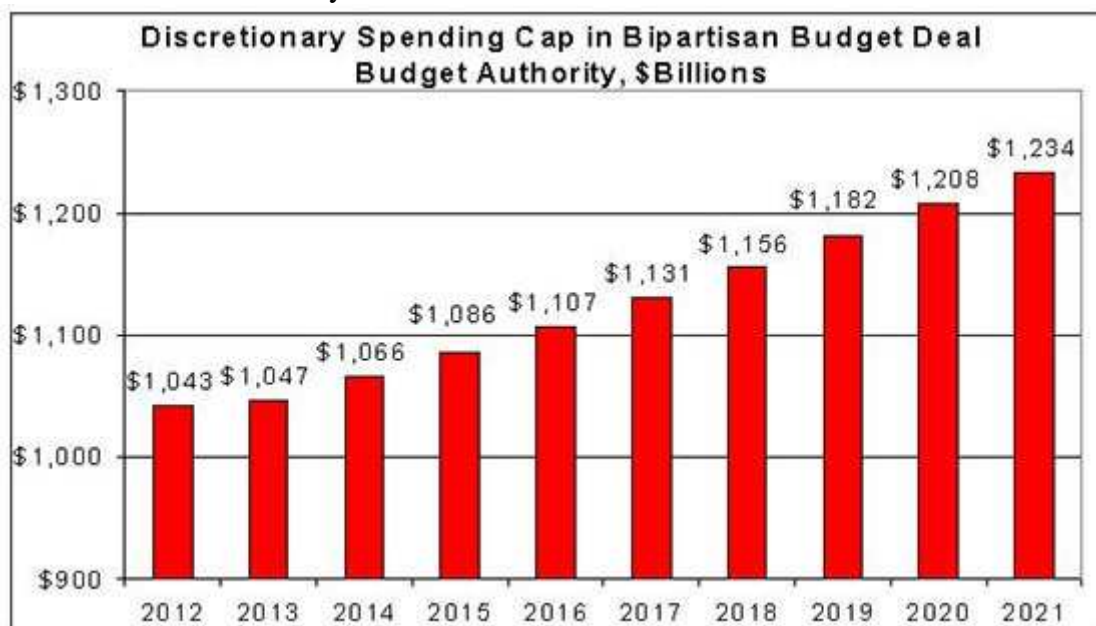
15 comments

With a bit of brinkmanship the US government (comprising the two houses of Congress and the executive) have agreed to spending cuts. As Steve notes below this is being seen as something of a victory for Republicans and the Tea Party. The Wall Street Journal is pushing a 'this is a good outcome for now' line.

The big picture is that the deal is a victory for the cause of smaller government, arguably the biggest since welfare reform in 1996. Most bipartisan budget deals trade tax increases that are immediate for spending cuts that turn out to be fictional. This one includes no immediate tax increases, despite President Obama's demand as recently as last Monday. The immediate spending cuts are real, if smaller than we'd prefer, and the longer-term cuts could be real if Republicans hold Congress and continue to enforce the deal's spending caps.

To be fair – getting a deal that doesn't raise taxes now but does cut spending now is probably a huge victory. This notion that budgets must be balanced but it doesn't matter if it happens at a high or low balance is wrong. Lower taxes and less government spending is also better than higher taxes and more government spending.

What I'm wondering about is how real are the spending cuts? Chris Edwards at the Cato Institute doesn't think they're real at all.



Wait a minute, those bars are rising! Spending isn't being cut at all. The "cuts" in the deal are only cuts from the CBO "baseline," which is a Washington construct of ever-rising spending. And even these "cuts" from the baseline include \$156 billion of interest savings, which are imaginary because the underlying cuts are imaginary.

No program or agency terminations are identified in the deal. None of the vast armada of federal subsidies are targeted for elimination.

If I understand the Edwards argument correctly, this is the sort of spending cuts that we often see here in Australia. Here the government cuts proposed spending in the forward years of the budget. Actual spending continues to rise but at a lower rate than what was previously budgeted.

The fact of the matter is that the US still needs to borrow to finance its deficits and that means tax rises have simply been deferred over the political horizon. Here is Dan Mitchell explaining how that could work – he hasn't changed his mind either. On the other hand, the WSJ is more optimistic.

One reason to think tax increases are unlikely, however, is that the 12-Member committee will operate from CBO's baseline that assumes that the Bush tax rates expire in 2013. CBO assumes that taxes will rise by \$3.5 trillion over the next decade, including huge increases for middle-class earners. Since any elimination of those tax increases would increase the deficit under CBO's math, the strong incentive for the Members will be to avoid the tax issue. This increases the political incentive for deficit reduction to come from spending cuts.

So the logic is that US taxation is going to rise anyway so politicians won't want to increase taxes again. At the same time, this logic suggests that those tax cuts won't become permanent.

All up, however, the WSJ is optimistic.

The tea partiers pride themselves on adhering to the Constitution, which was intended to make political change difficult. Yet in this deal they've forced both parties to make the biggest spending cuts in 15 years, with more cuts likely next year. The U.S. is engaged in an epic debate over the size and scope of government that will play out over several years, and the most important battle comes in the election of 2012.

Tea partiers will do more for their cause by applauding this victory and working toward the next, rather than diminishing what they've accomplished because it didn't solve every fiscal problem in one impossible swoop.

To the extent that politics is the art of the possible and the WSJ editors have a good grasp of US political realities they may be correct – my view is that the cuts aren't as good as they appear.

