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The Proper Post-Election Agenda: Cut Spending, Then Taxes

By Doug Bandow - 11/5/2012

Barack Obama, tax-cutter? As the election campaign wound down the president apparently was considering a new tax cut to stimulate the still sluggish economy. But his administration only was privately discussing—the deputy White House press secretary officially declared that nothing was being contemplated "at this time"—a limited package of temporary cuts. Far better is Mitt Romney's proposal for fundamental tax reform.

Americans face a serious fiscal crisis. If the U.S. was a family it would declare bankruptcy. The official national debt is $16.2 trillion. But economist Laurence Kotlikoff and columnist Scott Burns figure that "the U.S. government's fiscal gap — the true measure of the nation's indebtedness"—is $222 trillion, or about 14 times as much.

This "fiscal gap" did not result from the Bush tax cuts. According to the Heritage Foundation and Tax Foundation, those tax reductions only accounted for 14 to 16 percent of the $12 trillion net shift from surplus to deficit during the Bush administration. Maintain the cuts and the federal government still will be collecting a larger share of the GDP in the future than the average over the last 40 years. The coming tsunami of deficits and debt instead will result from a sharp increase in spending on entitlements: Social Security, Medicare, and Medicaid.

Nor, despite the meme promoted by the president and his allies, is there a problem of "the rich," however defined, failing to pay their "fair share" of taxes. The wealthiest top one percent pays 36.7 percent of income taxes. The top five percent pays 58.7 percent, the top ten percent pays 70.5 percent, and top quarter pays 87.3 percent, and the top half pays 97.8 percent. The Reagan tax reform essentially ended income taxes for the lower half of earners. Indeed, because of refundable tax credits, members of the bottom 40 percent actually collect more than they pay. Higher income Americans also pay the bulk of other taxes.

With Uncle Sam running trillion dollar annual deficits, the immediate necessity is big spending reductions. The real cost of government is expenditures. Whether Washington taxes or borrows, it is consuming valuable private resources. The resulting opportunity cost is lost private investment and consumption. Today government is spending far too much.

The political obstacles to cutting outlays are obvious. Looting and pillaging are big business in Washington. There are numerous abusive and wasteful programs which should be eliminated, such as pork and earmarks, foreign aid, corporate welfare, agricultural subsidies, and endless grants to most everyone. The federal government has created dozens, even scores, of health care, education, transportation, housing, job training, and welfare programs: Washington should start subtracting rather than adding duplicative and ineffective programs. The number, salaries, and pensions of civil service personnel are bloated and should be cut.

None of these expenditures involve a lot of money in Washington terms, however. Getting federal outlays under control requires going after the big boulders in the budget. The largest is Social Security. In the short-term benefits should be means-tested (that is, limited to those of modest income); in the longer-term the program should be privatized, with new workers allowed to shift their payroll taxes into personal retirement accounts. Medicare also needs to be means-tested: taxpayers no longer can afford to provide health care for Mitt Romney or Barack Obama. Both Medicare and Medicaid should be turned into risk-adjusted, income-adjusted vouchers, allowing poor beneficiaries to purchase health insurance policies that best meet their needs.

Finally, Washington should stop treating the defense budget as a form of foreign aid. The U.S. accounts for roughly half of the world's military outlays, even though most of these expenditures have nothing to do with protecting America. Instead, the U.S. subsidizes wealthy allies throughout Asia and Europe and engages in fruitless nation-building in failed states, such as Afghanistan. Terrorism remains a serious threat, but expensive carrier groups, air wings, and armored divisions have little role to play in combating such irregular attacks. Washington should slash commitments, force structure, and outlays.

Unfortunately, the administration has little interest in reducing federal expenditures. Every year President Obama proposes to spend more. He realizes that a budget deal is mandatory, but he will push any compromise towards higher taxes rather than lower outlays. Indeed, were politics not a factor, the administration's inclination would be to raise everyone's taxes in order to have more money to spend.

Mitt Romney talks a better budget game, but he has proposed few specific budget cuts—and wants to *increase* military outlays. Moreover, throughout his political career he has taken virtually every position on every issue. No one knows how he would actually govern as president.

Shrinking spending would ultimately allow reductions in taxes. Any cut that returns more money to the people who earned it would fulfill a worthy moral objective. However, temporary rebates do nothing to improve economic incentives. A rebate typically doesn't reward anyone for working harder, longer, or more creatively. And temporary cuts don't encourage anyone to invest or otherwise change behavior over the long-term. Temporary rebates are a bit like finding money on the street—an unexpected bonus, but one offering no permanent or systematic economic benefits.

Unfortunately, to the extent that the Obama administration is willing to consider tax cuts, it prefers to treat them as a Keynesian stimulus, essentially as a substitute for more government outlays. Despite official denials, the administration apparently has been talking about proposing some sort of temporary rebate in the coming months. That also was the administration position on the payroll tax cut first applied in 2011, which expires at the end of this year.

Of course, the president, with the election at stake, said he supported extension of the Bush tax rate cuts for those making less than $250,000 a year. But since those making more actually pay the most in taxes, it would be both fairer and more efficient to preserve the rate reductions for everyone.

In contrast to Obama, Romney apparently understands that tax cuts are not the same as government expenditures. And he appears to recognize that reducing taxes does not take money from Peter to pay Paul but instead returns tax payments to earners, that is, gives Peter back his own money.

Romney supports continuing the Bush tax cuts. Moreover, Romney is pushing tax reform which would trade lower rates for fewer deductions. It's a repeat of the Reagan reform. Unfortunately, Romney has done little to sell the proposal, refusing to offer details since the only way to significantly cut rates is to end popular write-offs, such as the home mortgage deduction. Moreover, with his history of flip-flopping it is hard to judge Romney's commitment to such a program. Nevertheless, he seems more likely than President Obama to challenge the scandalous federal tax system.

America faces a fiscal crisis. Whoever wins tomorrow's vote cannot avoid having to make tough budget choices. Federal outlays must come down—significantly and immediately. Getting spending under control would allow taxes to be cut as well. The best way to do so is through permanent rate reductions, not temporary rebates. And such cuts should be enacted as part of more general tax reform. Such a transformation would be a worthy agenda for whoever is elected president tomorrow.