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Obamanomics Explained

Lower tax rates caused the 2008 crisis, so higher tax rates will fix the fiscal cliff.

By Alan Reynolds - NOVEMBER 6, 2012

In a recent *Wall Street Journal* op-ed (November 2) President Obama wrote that "in the eight years after" Bill Clinton left office, "we followed a different path. Bigger tax cuts for the wealthy we couldn't afford. . . . The result of this top-down economics? Falling incomes, record deficits, the slowest job growth in half a century, and an economic crisis . . ." Obama had taken up that theme during the first presidential debate, arguing that "The approach that Governor Romney's talking about is the same sales pitch that was made in 2001 and 2003, and we ended up with . . . the worst financial crisis since the Great Depression."

This is a remarkably imaginative theory — albeit one that reveals appalling economic illiteracy. Who else would have imagined that the housing bust and subprime-mortgage crisis were actually caused by cutting the top two tax rates in mid-2003?

In the second debate, Obama repeated that "The last thing we need to do is to go back to the very same policies that got us there" — meaning top marginal tax rates that were slightly reduced, yet still higher than in 1988–92. Instead, he proposed, "for [incomes] above $250,000, we can go back to the tax rates we had when Bill Clinton was president. . . . That's part of what took us from deficits to surplus. It will be good for our economy and it will be good for job creation."

This is Obamanomics in a nutshell: Reducing the highest tax rates led to financial crisis, so raising the highest tax rates "will be good for job creation." Huh? What sort of economics is that? Obama suggests that raising the top two tax rates will turn deficits into surpluses, which would now be good for our economy. Isn't he the one who used to say huge deficits were a "stimulus"? In reality, of course, raising the top two rates is merely a symbolic gesture of revenge against successful people who often vote the wrong way. It would raise even less revenue (even ignoring its poisonous impact on the economy) than Obamacare hopes to collect from the same over-$250,000 group if they remain foolhardy enough to save and invest.

So, here we are facing a $536 billion tax increase on January 1 — the only “fiscal cliff” that matters — and Obama has been invoking his theory to block any medium-term solution (including the sequestration) that might *ever* cut federal spending below 23 percent of GDP. Instead, Obama has repeatedly insisted that he will never accept any solution to the looming tax shock that does not raise the top two tax rates. As the *Wall Street Journal* reports, “Some say a win for the president could spark . . . a selloff in riskier investments such as stocks. That is because . . . President Obama has said he would veto any extension of upper-income tax cuts.”

As strange as Obama’s economic theory is (the idea that lower tax rates cause crises while surpluses stimulate the economy), his perception of the facts also ignores his own Treasury Department. The Obama Treasury estimates that to “reinstate the 36 percent and 39.6 percent tax rates for upper income taxpayers” would raise only $23.1 billion in 2013. That is not even as large as Obamacare’s 3.8 percent surtax on the same “rich” taxpayers’ capital gains, dividends, interest income, and rent. Raising the top two rates offsets barely 4 percent of the tax hikes brought on by the fiscal cliff — scarcely sufficient reason to threaten to veto any bipartisan solution to the remaining $513 billion of looming tax increases.

What about Obama’s plans to raise other tax rates on upper incomes? The Obama Treasury estimates that taxing long-term capital gains at 20 percent “for upper-income taxpayers” (not counting the Obamacare surtax) would raise $5.8 billion in 2013, but lose $5.9 billion in the following two years. That adds up to less than zero. Treasury foolishly expects some small change from raising the dividend tax from 15 percent to 43.4 percent, but the resulting flight from stocks would obviously crash both the market and the economy.

Barack Obama does not understand economics and apparently refuses to listen to those who do.