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The fiscal cliff's not the problem

By DANIEL J. MITCHELL - December 2, 2012

Washington is consumed with wrangling over how to deal with the specter of big automatic tax hikes that will hit Jan. 1 when the Bush tax cuts expire. It's also the day that the sequester kicks in, which is the budget-wonk term for an automatic process that will slow the growth of government spending over the next 10 years.

This is the so-called fiscal cliff; it's a fight that has important implications, particularly since some of the tax increases will have a significantly harmful impact on incentives to work, save, invest and create jobs. In a competitive global economy, for instance, it is bizarrely self-destructive to increase the double taxation of dividends and capital gains.

And keep in mind that taxpayers already are getting thrown down a steep hill. A bunch of ObamaCare-related tax hikes are also set to take effect in January, most notably higher tax rates on investment. And the payroll-tax holiday will almost surely expire as well; it may have been an ineffective gimmick in terms of job creation, but it did make a difference for family budgets. Plus, millions of Americans face the specter of getting dragged into the indecipherable swamp of the Alternative Minimum Tax if lawmakers don't take action.

This is all bad news, but it is not a crisis. If we go over the cliff, it simply means the economy will grow a bit slower and politicians will spend a bit more money. And the sequester actually would be (modest) good news, since it means the burden of government spending would be "only" $2 trillion higher 10 years from now, rather than $2.1 trillion higher.

And even if Obama prevails in the fight, that simply means that we get a different mix of tax hikes and spending rises at a faster rate. Sure, that's bad for the economy, but it's not the end of the world.

The real crisis is the ticking time bomb of entitlement programs and the welfare state.

This bomb won't explode this year or next year. It may not even explode for another 20 years. But at some point America will experience a Greek-style fiscal collapse if these programs are not reformed.

It's a simple matter of math due to an aging population. According to both the Bank for International Settlements and the Organization for Economic Cooperation and Development, the future burden of US spending will climb so high that we'll be in worse shape than Europe's welfare states.

Worse than Spain, worse than Italy, worse than France. Our long-run fiscal outlook is even worse than the situation in Greece, according to those international bureaucracies.

A lot of people get upset about the national debt, which is somewhere between $11 trillion and $16 trillion, depending on whether you include money the government owes itself. Those are big numbers — but if you add up the amount of money that the government is promising to spend for entitlement programs in the future and compare that figure to the amount of revenue that the government projects it will collect for those programs, the cumulative shortfall is more than $100 trillion.

And that's *after* adjusting for inflation.
Some politicians claim this huge, baked-into-the-cake expansion of government isn't a problem, because we can raise taxes. But that's exactly what Europe's welfare states tried — and it didn't work.

Simply stated, even huge tax hikes won't stem the flow of red ink in the long run if government keeps growing faster than the private economy.

This is the fiscal problem that demands attention. Absent real entitlement reform, such as block-granting Medicaid to the states, the burden of government spending will consume ever-larger shares of our economic output with each passing year.
It won't matter if politicians enact Obama's class-warfare tax hikes. It won't matter if they hike payroll taxes on the middle class. It won't even matter if they impose the value-added tax, which is a European-style national sales tax. So long as government spending grows faster than the private sector, it's just a matter of time before international investors pull the plug and stop buying our debt.

Unfortunately, the longer we wait to fix the problem, the harder it will be to solve. More and more Americans will become trapped into lives of government dependency over time, the private economy will be too suffocated by taxes to create jobs, and we could wind up like Greece — with the majority of the voting-age population determined to support the status quo.

But when the status quo is unsustainable, the "bond vigilantes" will be the ones in charge. And when they cut up Washington's credit card, it won't be a pretty situation — especially since there won't be anybody left to bail us out.

Compared to that scenario, the fiscal cliff is a walk in the park.