

## Obama's Fear of Spending Cuts

Raise taxes to replace spending cuts and watch the economy slow.

By: Michael Tanner - February 27, 2013

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According to President Obama, the \$62 billion in new taxes this year imposed as part of the fiscal-cliff deal will have no effect on economic growth. In fact, the president believes that he can safely impose another \$58 billion in tax increases to replace spending cuts from the upcoming sequester. And, of course, Obamacare's almost \$42 billion in new taxes (and regulations) in 2013 don't have any impact on hiring or investment. But, the president says, the \$44 billion in cuts this year resulting from the sequester will throw the U.S. economy back into recession.

The president seems to labor under the impression that nearly all government spending adds to the economy and that wealth in private hands does not. Certainly, though one can debate the relative efficiency of programs funded by the government, a case can be made that some government spending can add to economic growth when such spending truly represents an investment (to use the president's favorite buzzword) in, for example, scientific research, infrastructure, or education. In reality, however, most government spending has little to do with investing. Even under a fairly broad definition of "investment," such spending represents less than 13 percent of this year's budget. By far, most of the rest consists simply of transfer payments — that is, taking money from one person and giving it to another. Transfer payments add to GDP only in a technical sense, but they do not create any new wealth or increase productivity.

President Obama may think that the rich sit around like Scrooge McDuck, watching piles of money in their vaults, but in reality individuals, even rich ones, either spend their money or they save and invest it. If they spend it, it helps provide jobs for the people who make and sell whatever it is they buy. If instead the money is saved or invested, it provides capital to start businesses and hire workers. And so, even in those few cases where government spending can be termed an investment, it displaces a certain amount of private investment, thereby reducing the net return on the government's action.

That would suggest that cutting government spending, even through an admittedly flawed process such as the sequester, might ultimately be better for the economy than preserving government spending at the cost of higher debt or taxes.

But, as the president and his supporters (Paul Krugman in every other column, for example) might respond, hasn't Europe shown us that cuts in government spending can devastate an economy? Great Britain is held up in particular as an example of how a country cannot cut its way to prosperity. Britain has embraced austerity and its economy has slipped back into recession.

But Britain actually shows just the opposite. The British government has made few real spending cuts. In real terms, total government spending did decrease marginally from 2011 to 2012 by £11 billion, or 1.6 percent of total spending, but it still remains £55 billion above 2008 levels after adjusting for inflation. On the other hand, there have been plenty of tax hikes,

including increases in the Value Added Tax (VAT), income taxes for high earners, capital-gains taxes, payroll taxes, and taxes on home sales. Sound familiar?

Veronique de Rugy of the Mercatus Center has pointed out that in Europe generally, countries have raised taxes far more than they have cut spending. To blame slow European growth on spending cuts, then, would be quite a stretch.

In the U.S., the cuts under the sequester amount to roughly 0.3 percent of GDP. No doubt they will impose a certain amount of pain on individuals directly affected and on communities that depend heavily on federal payments. But they are unlikely to tank the U.S. economy. On the other hand, continuing to raise taxes or to run massive deficits will almost certainly continue to slow economic growth.

Higher taxes, more spending, more debt — that, not the sequester, is something we should really be afraid of.