The Washington Times

RAHN: The real test for the GOP

Republicans will need courage to cut spending

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The Washington Times

6:27 p.m., Monday, November 8, 2010

Did you know that federal government spending and revenues in 1968 as a percentage of gross domestic product (GDP) were almost identical to the levels in 2008? The surprising fact is that for the past 50 years (until the last tw years) federal spending and tax revenues have been remarkably constant as a percentage of GDP, as can be seen in the accompanying chart.

What is new is the big jump in federal government spending in the past two years, from an average of about one-fifth of GDP to about one-quarter of GDP, and to this must be added another 13 percent for state and local government spending as a percentage of GDP, causing the total government sector to rise from about one-third of GDP to almost 40 percent.

Federal spending during the last half-century averaged slightly more than 20 percent of GDP, and revenues averaged slightly more than 18 percent of GDP, leaving an average deficit of slightly more than 2 percent of GDP. From 1984 to 2008, average economic growth was greater than the average deficit, so government debt as a percentage of GDP actually fell. (An individual can increase his absolute amount of debt each year and be better o if the value of his assets is growing even faster and if his income grows more rapidly than the payments required to service the debt - the same is true for governments.)

From 1968 until 2008, the federal government grew far larger in absolute terms, but not relative to the economy. But over the past half-century, the government has become far more intrusive, with ever-expanding, costly regulation and mandates on state and local governments.

As everyone knows, the United States is running record and unsustainable deficits of roughly 10 percent of GDP. President Obama's solution was to appoint a "deficit reduction" commission this past February - the National Commission on Fiscal Responsibility and Reform - which is due to report no later than Dec. 1. Before this month's election, the betting had been that the commission would propose $3 in spending reductions for every dollar in proposed tax increases. A spending problem cannot be solved with tax increases, in part because tax increases slov economic growth, thereby fueling the demands for more spending.

The majority of the members of the commission are members of Congress, one of whom was defeated (Democrati Rep. John M, Spratt of South Carolina) and a couple who are retiring. Most of the Republican members are unlike to go along with any proposal for tax increases, so there will not be a consensus.

The Republicans' big test is that because they oppose tax increases - correctly in my judgment - they must propose ways to bring down government spending to the historic average of about 20 percent of GDP. Tax revenues have only been running about 15 percent of GDP for the last couple of years, but that unusually low level is because of the recession. Given the progressive nature of the U.S. tax system, revenues fall more rapidly during an economic slowdown and rise more rapidly during good times. The current tax rates, which include the so-called George W. Bush tax cuts, produced tax revenues slightly greater than the historical average of 18 percent in 2006 and 2007, s again, the problem is not one of tax revenue; the problem is spending.

Remember, fractions have both a numerator and a denominator - the numerator being the level of government spending and the denominator being the size of the economy. Government spending as a percentage of GDP can b brought down by increasing the size of the economy while holding government spending constant, by cutting government spending or by engaging in some combination of the two. President Reagan was constrained by the Democrat-controlled Congress as to how much domestic spending reduction he could achieve while at the same time wishing to increase defense spending to win the Cold War. He was able to meet most of his objectives by engaging in pro-growth tax-rate cuts and regulatory restraint, which resulted in an economy growing rapidly enoug to bring down government as a percentage of GDP and reduce deficits to a sustainable level.

If Mr. Obama is wise, he will allow Congress to extend all of the Bush tax-rate cuts, allow the Republicans to cut wasteful and counterproductive spending and cut back on excessive regulations by not vetoing their proposals. If h is not wise, he will continue with his anti-economic growth, tax, spending and regulatory excesses.

The Republicans will be able to cut some discretionary spending, but they will not be able to deal with the real problems of "entitlement" spending - the biggest problems being Medicare and Medicaid - without the president's cooperation. The real test for the Republicans: Will they be courageous and responsible in proposing real solutions to the spending problem, or will they "punt" like the Democrats and watch the economy go over the cliff?

Rep. Paul Ryan, Wisconsin Republican, one of the smartest members of Congress and the most economically literate (and also a member of the "deficit reduction" commission) has shown the way by developing his "road ma to deal with the entitlement problems and bring spending back to its historical levels. Mr. Ryan manages to be re-elected by wide margins in a majority Democrat district because voters understand that he is serious about dealing with the federal budget in a responsible way that will minimize hardship and not add to tax burdens. Most voters a not stupid, and most of them are already aware that changes must be made in Social Security and medical entitlements. If the Republicans get smart like Paul Ryan, do their homework and learn how to explain constructiv solutions to the entitlement problems, they can win despite the childish rants of know-nothing Democrats who wa to pretend that the current course is sustainable.

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