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Stefan Karlsson's Blog

Starve the beast? It's a poor way to cut the deficit.

The 'starve the beast' strategy – raising spending but not taxes – hasn't cut the deficit.

Georgetown University's mascot Jack the Bulldog takes a drink during the college's men's basketball game versus Duke University in Washington on Jan. 30. When it comes to paying for new government programs, a 'starve the beast' strategy does a poor job of cutting the deficit.

Alexis C. Glenn/Pool via CNP/Newscom/File

By Stefan Karlsson, Guest blogger / May 9, 2010

These days, I only rarely agree with Bruce Bartlett's writings. But he does have a point here, citing Bill Niskanen, about why the "Starve the Beast"-strategy for containing government spending may not work:

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"For some years Bill Niskanen of the libertarian Cato Institute has argued that STB actually increased spending and made deficits worse. His argument is that the cost of spending is ultimately the taxes that will have to be raised to pay for it. Thus fear of future tax increases was the principal brake on spending until STB came along. By eliminating tax increases as a necessary consequence of deficits, it also reduced the implicit cost of spending."

The point here is that if people do not associate higher spending with the

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sacrifice consisting of higher taxes, then many voters will feel that all higher spending results in is more money from the state, while in the past when deficits were shunned, people associated higher spending with the sacrifice of higher taxes.

If for example Bush's big spending increasing schemes, the "No Child Left Behind" act, the Medicare prescription drug benefit act and the Iraq war, had been fully funded by tax increase, then it seems likely that there would have been stronger opposition to them.

Thus, at least in the short-term, "Starve the beast" might increase spending.

The fact that interest payments will become a bigger cost in the budget if a government runs up a big national debt is also something that in the long term will increase spending.

Whether or not that remains the case in the long run depends on how high cost in the long term that high deficits are associated with, something which in turn depends on how vigilant the bond market is.

If a country's bonds are considered a "safe haven" (and through the self-fulfilling prophecy mechanism becomes a "safe haven") by credit rating agencies and the bond market, like for example the United States and Germany (and to lesser extent Britain and France), then the political price of high deficits will probably be lower than the political price of higher taxes, meaning that tax cuts or the absence of tax increases probably increases spending.

By contrast, a country's bonds are considered to be "unsafe" (and through the self-fulfilling prophecy mechanism becomes "unsafe"), as is the case these days (but wasn't until recently to any major extent) with Greece and Portugal (and to a lesser extent Spain and Italy), then deficits will put stronger pressure to reduce spending than higher taxes.

Also relevant is the relative popularity among the general population for keeping taxes low or keeping spending high. If keeping taxes low taxes is more popular than keeping spending high, than "Starve the beast" might work. But if the reverse is true, than it will never work.

That is of course why a popular fix is raising taxes for the wealthy. The majority of people usually don't mind if a small majority of rich people pay more in taxes, but they usually do oppose paying higher taxes themselves. The problem is that tax increases for the rich can usually at best only fill a small part of the large budget gaps that most countries have, especially if you consider the growth depressing (and tax evasion increasing) effects of such tax increases. Indeed, if you have gone too far along the Laffer Curve, such tax increases might even reduce revenues. In reality, politicians will be forced to either cut spending or raise taxes for people with low or moderate income-or both cut spending and raise taxes for "normal people".

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