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Gorging the Beast

Tax cuts didn't starve big government.

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A dedicated libertarian, William Niskanen was also a dedicated pot-stirrer. For him the two vocations—pressing the case for small government and, at least intellectually, making trouble—were inseparable. He was best known as an original member of Ronald Reagan's Council of Economic Advisers, one of a principled band of Reaganites who followed their man into the White House and then drifted away as Reagan succumbed to political compromise and ideological deviationism. For the rest of his professional life (he died last year) he worked as chairman of the Cato Institute, the country's sanest libertarian institution.

Beginning in 2002, Niskanen published a series of papers and op-eds about tax cuts and spending increases that turned conventional conservative wisdom on its head. Since both taxes and spending are much in the news, his critique is worth another visit.

If we wanted a smaller government, he said, we would have to raise taxes.

Most people who work in politics and government in Washington have heard the phrase "starve the beast"; many normal people are familiar with it too. According to the historian Bruce Bartlett, a former Republican aide and now a bestselling author, the phrase was first publicly applied to tax and spending matters in 1985.

Lamenting the failure of the Rea- gan administration to cut the fed- eral budget, an unnamed official told a Wall Street Journal reporter: "We didn't starve the beast." He meant the administration had been unable or unwilling to shrink the size of the federal government by depriving it of revenue through tax cuts. The reve- nue-deprivation part worked fine; the Reagan tax cuts of 1981 were mostly still in effect in 1985. But there had been no shrinkage. The beast was fatter than ever.

The concept of starving the beast was older than the phrase. An earlier metaphor involved unruly children. In a 1980 presidential debate, Rea- gan scoffed at the idea that Congress would have to cut federal spending before it cut taxes.

“If you’ve got a kid that’s extrava- gant, you can lecture him all you want about his extravagance,” said Reagan. “Or you can cut his allow- ance and achieve the same result much quicker.”

Milton Friedman liked the metaphor too.

“How can we ever cut government down to size?” he wrote. “I believe there is one and only one way: the way parents control spendthrift chil- dren, by cutting their allowance. For government this means cutting taxes. Resulting deficits will be . . . the only effective restraint on the spending propensities of the executive branch and the legislature.”

With such bona fides—Alan Greenspan, passing through one of his conservative phases, had advocated starving the beast too—Republicans seldom questioned the theory of STB, using it over the last three decades as an ironclad argument for low taxes.

And then Niskanen, looking over 25 years of budget data, noticed something about STB: It didn’t work. In fact, attempts to starve the beast by tax cuts seemed to lead to increased federal spending.

Niskanen looked at both spending and taxes as a percentage of GDP. On average, he found, if federal revenues declined by 1 percent, federal spend- ing increased by 0.15 percent. When revenues rose, on the other hand, relative spending decreased. A fur- ther study in 2009 by another Cato economist, Michael New, came to the same conclusion after the gluttonous administration of George W. Bush. Under Bush and his mostly Republican Congress, new benefits like subsidized Medicare drugs and increased federal education spending followed on the heels of large tax cuts.

Niskanen’s explanation for the failure of STB was straightforward, a conjecture based on standard eco- nomics: When you cut the price of something, demand for it will increase. Lowering taxes without lowering benefits meant that tax- payers were getting the benefits at a discount. The government made up the true cost with borrowed dollars that future taxpayers would have to repay. There was a big difference, Niskanen said, between a kid on an allowance and the federal government: The government has a credit card with no debt limit.

A study by a pair of liberal economists in 2004 showed how thoroughly the desire to cut taxes had been made compatible with the desire to spend money and expand the government's power. Among con- gressmen who had signed a pledge never to raise taxes, presumably on starve-the-beast grounds, more than 80 percent nevertheless voted for the mostly unfunded Medicare prescrip- tion drug benefit in 2003. More than 70 percent of them voted for the lard- packed farm and transportation bills in Bush's first term.

Reagan, Friedman, and other early advocates of STB had counted on something that never material- ized. They had assumed that as the debt piled up to finance annual bud- get deficits caused by free-flowing benefits, public outrage would force politicians to restrain spending without raising taxes. Yet we've had the deficits and the borrowing, in amounts that would have left Fried- man and Reagan agog; what's been missing is the outrage.

As compelling as Niskanen's cri- tique is, he was less persuasive in explaining the flip side of his find- ings. Why do tax increases lead to decreased spending? "Demand by current voters for federal spend- ing," he explained, "declines with the amount of this spending that is financed by current taxes." When you make them pay for government benefits out of their own pockets, in other words, voters will want fewer of them. The journalist Jona- than Rauch put Niskanen's point more pithily: "Voters will not shrink Big Government until they feel the pinch of its true cost."

For that reason, the great liber- tarian pot-stirrer said that spending would never decrease—that govern- ment would never get smaller—until federal revenues increased from 15.8 percent of GDP, where they are today, to higher than 19 percent of GDP: an amount totaling in the hundreds of billions of dollars.

This part of Niskanen's argument follows economic logic too—raise the price of something and people will want less of it—but it's still con- jectural. He had no way to measure whether demand for federal benefits was rising or falling among voters at any point in time. Most likely, it's always doing both, depending on the voter and the benefit. Niskanen's explanation assumes that there is a unitary demand for government ser- vices, and a unitary population of taxpayers who bear the cost.

Yet not all voters are taxpayers, at least not to the same degree. A pro- gressive tax code like ours is meant to redistribute wealth, so that people with less of it get more of it, in the form of government benefits. Under such a system, an increase in taxes— say, on the upper 2 percent of tax- payers—won't reduce demand for government services, because the demand isn't coming from the peo- ple who will "feel the pinch."

Of course, the cost of government comes not only through positive ben- efits, the checks that government writes. The government also confers benefits by forgoing revenue through tax exemptions for mortgage interest, charitable contributions, and thou- sands of other activities. The mort- gage interest exemption, for example, allows homeowners to pay fewer taxes than their fellow citizens who make the same annual income that they do. Repealing this exemption would also force homeowners at last to bear the "true cost" of government.

And yet in the current discussions our government officials aren't calling for eliminating the deduction for the vast majority of homeowners—only those with high incomes and expen- sive homes. America's homeowners won't feel the pinch of this kind of tax increase either. So why should they want to demand fewer benefits and shrink Big Government?

The only system that would sus- tain Niskanen's logic—raise taxes to reduce demand for government ben- efits—is one in which everyone pays the same percentage of their income in taxes. When taxes were increased to pay for government, everyone would feel the pinch. Such a system is called the flat tax. Good luck with that.

So we're right back where we started.

Reagan never showed a sign that his "starve the beast" strategy was failing, had failed. "Raising taxes won't bal- ance the budget," he said in his 1982 State of the Union address, as revenues fell and spending rose. "It will encour- age more government spending. . . ."

We know now Reagan was wrong. But that doesn't mean Niskanen was right. There may be reasons to raise taxes—if you give me a couple years I might come up with some—but the failure of "starve the beast" isn't one of them.

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