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Spending Growth—Not Tax Cuts—Is the Reason for Fiscal Imbalance

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Some critics of the Bush Administration charge that tax cuts have dramatically reduced government revenues, causing big long-term deficits that will hurt the economy by driving up interest rates. This is a misguided argument, not only because of a very weak relationship between deficits and interest rates, but also because historical budget data show that tax revenues in future years will be at their historical average—even if the Bush tax cuts are made permanent.

- The Bush tax cuts are not causing long-term deficits.
- Assuming the tax cuts are made permanent, federal tax revenues in 2012–2014 are projected to consume 18.1 percent of GDP—exactly the average annual tax burden for 1951–2000.

During the 50 years from 1951 to 2000, federal tax revenues averaged 18.1 percent of gross domestic product (GDP). Opponents of tax relief frequently imply that tax cuts have emptied government coffers and created long-term fiscal chaos, but tax revenues for 2012–2014 will average 18.1 percent of GDP, according to Congressional Budget Office (CBO) data. And this assumes that the tax cuts are made permanent. Critics would correctly point out that tax revenues are currently below that level, but this is a short-term phenomenon resulting from the recent recession and the temporary stock market–driven collapse of tax revenues from capital gains. The CBO, for instance, estimates that tax revenues will soon be back at historical norms, averaging 18.1 percent of GDP over the 2007–2009 period.

This does not mean that tax revenues should always be 18.1 percent of GDP. It is just a coincidence that average revenue collections and future revenue projections are identical as a share of national economic output. It *does* mean that the Bush tax cuts will not cause future deficits.

Government Spending. Deficits, however, are not the issue. The real problem is government spending, and rising deficits are merely a symptom of that problem. This is true in the short run and the long run. In the short run, federal spending has jumped dramatically, climbing from 18.4 percent of GDP in 2000 (the lowest burden of government since 1966) to more than 20 percent of GDP in 2004. But this short-term expansion in the burden of the federal government is minor when compared to what will happen after the baby-boom generation begins to retire. Without reform, huge unfunded promises for Social Security and Medicare will cause an enormous increase in federal spending—and lawmakers just made the problem worse by creating a new entitlement for prescription drugs.

It is also worth noting that national defense expenditures are not the source of the problem. Defense spending today consumes only 4 percent of

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GDP. This is an increase compared to defense spending at the end of the Clinton Administration, but it is very low compared to historical averages. For much of America's post–World War II period, defense spending averaged about 6 percent of GDP. Even during the Carter Administration, when a weakened military capability led to serious international crises, national defense spending never fell below 4.7 percent of GDP.

Finally, it is important to understand why government spending should be reduced (or at the very least, why its rate of growth should be slowed). Simply stated, the federal government squanders resources. When politicians spend money, regardless of whether that spending is financed by taxes or borrowing, they are taking money from the productive sector of the economy and allocating that money on the basis of political rather than economic considerations. This inevitably weakens economic performance.

Government spending also undermines the nation's social fabric. When lawmakers increase government spending to address a problem that previously was handled by families, communities, and local governments (such as education, shelter, or health care for the indigent), people in local communities lose their initiative and incentive to address the needs of their neighbors. Moreover, the federal government generally does a poor job of addressing the problem since decision-making shifts to bureaucrats who frequently have no connection to the local problem. In other words, when the federal government increases outlays for social programs, it causes social damage in a way that is similar to the way it harms overall economic performance.

This is why lower spending would still be a good idea even if the United States had a giant surplus. Regardless of whether the budget is in surplus or in deficit, government inevitably wastes money and deprives the private sector of resources that could be used to boost jobs and create growth. This is why discretionary spending should be reduced, including a long-overdue re-examination of entire programs, agencies, and departments. Lawmakers should also reform entitlement programs, in part to reduce long-term budget pressures, but also because private-sector methods are better at providing health care and retirement income.

Conclusion. Today's deficit debate is largely a charade. Proponents of big government shed crocodile tears about the deficit because they want higher taxes. Yet historical evidence clearly shows that higher taxes would encourage additional spending and hurt the economy—and this would cause the deficit to climb even higher. Even more worrisome, this approach would hurt U.S. competitiveness, making America more like France and other European welfare states.

To save our children and grandchildren from that dismal fate, we need to keep cutting taxes and finally get serious about reducing the burden of government spending.

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