STIMULATING THE ECONOMY REQUIRES STRANGLING GOVERNMENT SPENDING

It's the elephant in the room. But few besides W. Kurt Hauser seem to have noticed it.

Since World War II, federal tax revenues have only rarely, only barely, and only briefly exceeded 19 percent of the gross domestic product (GDP), noted Mr. Hauser, chairman of an investment management firm in San Francisco and chairman emeritus of the Hoover Institution at Stanford University, in the Wall Street Journal Nov. 26. (The average since 1950 has been a hair under 18 percent.)

This has been so when tax rates were high and when tax rates were low (during this period, the top marginal income tax rate has fluctuated between 28 percent and 92 percent); when the economy was strong and when the economy was weak.

How can this be?

Economist Arthur Laffer explained it all when he drew his famous curve on a napkin at the Two Continents restaurant in Washington D.C. in 1974.

When tax rates go up, Mr. Laffer explained to skeptical politicians, people have less incentive to work hard and invest, so the economy slows down. On the other hand, when taxes are cut, people have more incentive to be productive, and the economy speeds up.

Mr. Hauser noted that for a year and a half before the Bush tax cuts went into effect in May, 2003, the economy grew at an annual rate of 1.8 percent. In 18 months after, the economy grew at more than double that rate (3.8 percent).

Higher tax rates raise less revenue than politicians expect, because their imposition shrinks economic activity. Lower rates raise more revenue than politicians expect because there is more income to tax.

So though tax policy has a profound effect on the size of the economic pie, it has little impact on how much of it the government receives.

What are the implications of the fact that federal tax revenues will not for any length of time exceed 19 percent of GDP, no matter how high tax rates are raised?

The first is *we cannot shrink our mammoth budget deficits by raising taxes*. Since World War II, federal spending has averaged about 21 percent of GDP, but has ballooned to more than 24 percent of GDP during President Barack Obama's administration.

To cut the deficit, we must hold federal spending to 19 percent of GDP, or lower.

This would not be a hardship if the economy were growing. In the boom years of the late 1990s, federal spending as a percentage of GDP fell from 20.3 percent in the 1996 fiscal year to 18.4 percent in FY 2000.

That's the key phrase... if the economy is growing. President Obama's reckless spending has gravely endangered our economy. The national debt has risen from $9.5 trillion in August of 2008 to $13.7 trillion today. *We're currently borrowing $120 billion more per month.* This must stop, or catastrophe will ensue. Soon.

But bad as Mr. Obama's spending has been -- incoming House Budget Committee Chairman Paul Ryan, R-Wis, says federal spending has increased 84 percent during his administration -- it hasn't been the most harmful of his policies.

The worst thing about Obamacare isn't the roughly $230 billion a year it's expected to cost taxpayers once it is fully implemented. It's the immense costs it imposes on businesses which provide health insurance to their employees, and to consumers who provide health insurance on their own. Little has done more to keep businesses from hiring new workers.

A study conducted by Louisiana State University in July (which was funded by an energy advocacy group) estimated the moratorium on oil drilling in the Gulf of Mexico the president imposed will cost 8,000 jobs and $2.1 billion in economic activity.

The Heritage Foundation estimated in October that federal regulations cost the economy $1.75 trillion a year, double what the government collects in taxes from individuals.

"On every front, the federal government is creating more investment-killing tax uncertainty, issuing endless pages of new bureaucratic regulations on the economy, and preventing firms that could create hundreds of thousands of new positions and kick start a muscular recovery with real legs," said Washington Examiner editor Mark Tapscott.

We must cut federal spending. And we must stimulate economic growth. A good way to start would be by slashing spending for those agencies whose regulations are strangling the economy with red tape. Let's strangle the agencies' spending instead.

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