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The Spending 'Freeze' That Isn't

By Edward P Lazear

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In last night's State of the Union address President Obama proposed a three-year "spending freeze" on what amounts to one-sixth of the federal budget. Our biggest entitlement programs, Social Security and Medicare, would be excluded. These changes are optical rather than substantive. Given the spending agenda that is already in place, we can expect to see large increases in the proportion of GDP that is spent by our government for years to come.

Since 2008, the ratio of federal spending-to-GDP has risen by about 14%. From 2008 to 2009 we saw the greatest annual increase in spending in the last 30 years. In the name of stimulating job growth, the share of federal spending is now 24% of the economy, up from 21% in the last year of the Bush administration.

High taxes are clearly bad for the U.S. economy. For example, were we to tax above the 18% tax-to-GDP ratio over the next 25 years, GDP per capita in 2035 would be about 50% less than if we were to tax below the 18% ratio. A 50% per capita GDP differential is about as large as the difference between the U.S. and Greece today.

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