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Dean Baker and Ted Boettner: Deficit reduction, Wall Street, and whales

Last week, Sen. Manchin hosted the co-chairs of the federal deficit commission to discuss their draft proposal for deficit reduction. Sen. Manchin should be commended for bringing attention to our nation's finances and for hosting a lively discussion about the commission's proposal.

While there are admirable elements to the plan, it is unfortunate that deficit reduction has come to occupy center stage in the national political debate when clearly our country's biggest problem is the jobs deficit.

Nearly five years after the beginning of the recession, we still have more than 23 million people unemployed, underemployed or who have given up looking for work altogether. West Virginia would need an additional 27,000 jobs to reach its pre-recession level.

Deficit reduction in the near future will worsen the unemployment problem because it means pulling money out of the economy, either by increasing taxes, cutting government employment or cutting government payments like unemployment benefits and Social Security. Whichever way the government looks to reduce the deficit it will mean that there will be less spending, which in turn means employers see less demand and will want to hire fewer workers.

While people may want the private sector to fill the gap, employers don't hire workers until they see additional demand for their products, and this is not going to happen when the government is cutting the deficit.

Over the longer term, there is an argument that the government faces a deficit problem, but this is overwhelmingly a story of health care costs. We already pay more than twice as much per person for our health care than other wealthy countries and have little to show for it in terms of outcomes. If we paid the same amount per person as Canada or Germany, we would be looking at projections of huge budget surpluses rather than deficits.

This would seem to suggest the urgency of fixing our private health care system. Public sector programs like Medicare and Medicaid are actually more efficient than private insurers. The problem is that the private sector charges too much for care.

Unfortunately, Washington does not seem likely to go this route to deal with the deficit. The most widely cited plan for addressing the deficit is the proposal put forward by Morgan Stanley Director Erskine Bowles and former Sen. Alan Simpson, the co-chairs of President Obama's deficit commission.

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Their plan calls for cutting spending in a wide range of areas like health care research, education, and infrastructure by more than 20 percent over the next decade, even as the economy is projected to grow by close to 30 percent. That is likely to leave the economy ill-prepared to sustain healthy rates of productivity growth.

The plan also calls for large cuts to Social Security, most immediately a cut in the annual cost of living adjustment. It also raises the retirement age and phases in a reduced benefit formula for middle income workers, which would hurt many of West Virginia's working families.

These cuts would hurt tens of millions of current and near retirees who are already struggling. As it stands, tens of millions of baby boomers are approaching retirement with little other than their Social Security. Few have traditional defined benefit pensions. They saw their housing equity evaporate with the collapse of the housing bubble and much of what they put into 401(k)s got swallowed up by market turbulence and the fees charged by fund managers. The Bowles-Simpson Social Security cuts would be yet another setback to workers who have already been hit pretty hard.

The willingness to take another shot at workers is especially unseemly given Bowles-Simpson's decision to not go after the big winners in today's economy: Wall Street. Thanks to the Federal Reserve Board and TARP bailouts, the Wall Street banks are back on their feet and bigger than ever.

If there is a need to get additional revenue to address long-term deficit problems, Wall Street might be a good place to look. A modest tax on financial speculation could raise as much as $1.5 trillion over the next decade Sen. Tom Harkin and Rep. Peter DeFazio have proposed a more modest tax which the Joint Economic Committee estimates would raise almost $350 billion in the first nine years it is in place.

There is a long history of such taxes. The U.K. has taxed stock trades for more than three centuries. Several other major stock markets currently have transfer taxes and the European Union is considering such a tax as early as next year.

In addition to raising a great deal of money, a speculation tax could also dampen speculation since it would make it more costly. Most normal investors would feel little impact since they would

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reduce trading roughly in proportion to the size of the tax. This could mean that they pay twice as much for each trade, but only trade half as much, leaving total trading costs unchanged.

It is hard to understand why Bowles and Simpson did not consider taxing Wall Street. When he introduced the plan, Sen. Simpson commented that they had harpooned every whale. Ironically the trading unit at J.P. Morgan that was at the center of the scandal that may have cost the bank $5 billion was known as the "London Whale." This appears to be one whale that Bowles and Simpson overlooked, but hopefully one that West Virginia's congressional delegation will not.

Baker is the co-director of the Center for Economic Policy in Washington D.C., and Boettner is the executive director of the West Virginia Center on Budget and Policy.

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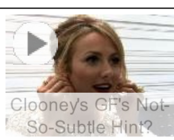

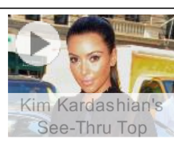

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