First Trust
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THE ECONOMIC ANTIDOTE

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The Super Committee – Much Ado About Little

We don't watch that much television, but every time we turn on cable news, someone is talking about the Super Committee – the 12 members of Congress tasked to cut the deficit over the next 10 years by $1.2 trillion.

Supposedly – at least according to the talking heads – the Super Committee is the biggest and most important issue facing the economy. One news anchor said that committee decisions will determine how retailers do this year during the holiday shopping season. Others are trying to make the case that failure to come to agreement threatens another recession.

Pardon me when I say – "Give me a break." According to the Congressional Budget Office, total federal government outlays in the next 10 years (2012-2021) are expected to be $44 trillion, while GDP will total $195 trillion. If we assume that the committee does not raise taxes at all, which means the $1.2 trillion is all spending reduction, this would equal just 2.7% of the budget, and 0.6% of GDP.

These spending reductions represent just $2.70 out of every $100 dollars of government spending and 60 cents out of every $100 dollars of GDP. This is miniscule – the size of a rounding error for GDP. And remember it's calculated over a 10-year period!

Like all government spending reductions, the impact on the out years is much larger than the impact on the early years. In other words, spending reductions in 2012, 2013 and 2014 are much smaller. There will be absolutely no impact on government spending in 2011 and very little impact on spending in 2012. And if the committee fails to come to any agreement, automatic sequestration kicks in, but this won't actually start until January 1, 2013. So, how in the world can any of this impact retail sales over the next few months, or the economy over the next few years?

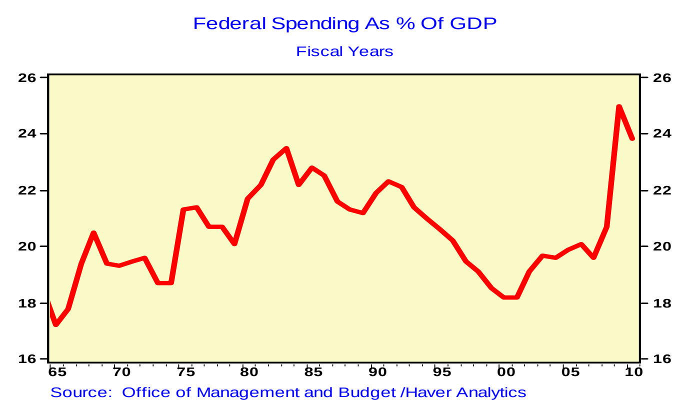
The answer – It can't and it won't.

However, by getting viewers to worry about it, and to tune in to watch minute by minute coverage, television helps itself. The Super Committee has become a creature of the media, and its impact is being exaggerated by a massive amount.

This does not mean that it is a complete non-event. Remember, the Super Committee was invented because Congress could not come to agreement as a full body. Putting aside whether or not a 12-member, sub-group can do anything that the full Congress can't do, the task of reducing deficits by $1.2 trillion is a movement in the right direction.

According to government estimates, if spending is cut by $1.2 trillion over the next 10 years, government spending will fall from a peak of about 25% of GDP to 22%. This is a positive (but somewhat minor) movement in the correct direction. Cutting spending is the most important thing Congress can do to boost economic growth, create jobs and lift stock markets to new highs.

We know this is not what our college professors teach us. We know this is not what conventional wisdom believes. But, history shows the truth. The chart below shows US federal government spending as a share of GDP over the past 46 years.



Federal spending increased from 18% of GDP in 1965 to 23% in 1982. During that time, stock prices went nowhere, P-E ratios fell, unemployment rose and the economy suffered. From 1982 to 2000, government spending was cut back to 18.5% of GDP. Stocks soared, unemployment plummeted and the economy boomed. Since 2000, as government spending shot up again, the economy has suffered, unemployment has climbed and stocks have flat-lined again.

The bigger the government is the smaller the private sector is and the smaller the private sector is the fewer jobs an economy creates. Cutting spending should be the focus of government policy.

Every extra dollar of tax revenue the Committee might agree to, will limit spending reductions. This is the only real danger of the Super Committee; that it somehow ends up raising taxes and not cutting spending. No agreement and a complete breakdown of the committee – which forces automatic sequestration – is better for the economy than a compromise that includes large tax hikes. But, no matter what happens, the impact of the Super Committee is being exaggerated in the extreme.