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Sequestration Drama

President Obama signed the order on Friday to execute the first \$85 billion in spending cuts that are a part of the decades-long, nearly trillion dollar sequestration. Leading into last week, the White House attacked Republicans for risking another economic crisis due to their refusal to accept a more “balanced” fiscal knife that included spending cuts and tax increases. Of course, any negative economic impact of the spending cuts will be negligible. The Democrats’ fear-mongering is based on Keynesian economic arguments that less money in people’s pockets will reduce economic growth. Nonsense. The sequestration spending cuts will have virtually no impact on reducing incentives by corporations and entrepreneurs to invest, and therefore they will have no meaningful impact on the economy and stock market. Any hit to GDP data will be marginal and unimportant. Noticeably, Gene Sperling is now arguing that the negative impact of the initial sequestration cuts will be gradual.

The most important aspect of the sequestration debate in Washington is whether Democrats will prevail in winning tax increases in exchange for spending cuts (or reforms). If they do, then growth and stocks could be threatened. But given the tax-related ideas floating in Congress, it is very difficult to imagine that such a scenario would include broadly dangerous, anti-growth tax increases.

Nonetheless, Republican lawmakers such as Lindsay Graham need to shut their trap about taxes. On Face the Nation, he said: “We don’t need to raise taxes to fund the government. We need to raise taxes to get our nation out of debt.” Graham has never genuinely understood supply-side economics. If he did, then he would understand that we need to cut taxes to get our nation out of debt (because the acceleration in economic growth would increase government revenues to pay off the debt). Case in point: the tax increases in Greece, Spain, Portugal and Italy have worsened their debt burdens by destroying their economies. Fortunately, John Boehner and Mitch McConnell are clear that they will hardly budge on revenue raisers after having accepted the tax increases enacted in January.

Also, from a political perspective, it is good that Boehner and McConnell are looking to avoid a government shutdown by month-end for fear of replaying Newt’s political disaster in 1995. Even Gingrich is saying these days that the GOP must avoid that.

Boehner’s House will look to pass a spending bill that funds the government into the fall. Democrats may play hardball with that bill in an effort to win a grand compromise on sequestration, but the odds of the Democrats forcing a shutdown are small. For now, we view the sequestration drama as much ado about nothing for the economy as long as serious tax increases are not considered.

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