

# Obamanomics

How McCain can fight back—if he cares to.

BY IRWIN M. STELZER

Every day that passes makes one thing clearer and clearer: Barack Obama knows precisely what he wants to do to the U.S. economy, and John McCain is intent on proving his self-confessed lack of knowledge with a charming set of homilies.

Start with Obama's proposal to raise taxes on all families earning more than \$250,000 per year in order to finance a \$1,000 tax cut for "middle-income" tax payers. Assuming that there is enough money to be had from taxpayers in that higher-income class to fund the cut for the much larger number of middle-income earners—a heroic assumption—McCain's charge that Obama is planning a massive tax increase doesn't apply to this overt redistribution of the tax burden. Taking from Peter and giving to Paul is not an increase in the taking.

Nor can this rejiggering of the tax burden be dismissed out of hand. The transfer of income from one taxpayer to another does not reduce total welfare. Indeed, the Obama proposal arguably increases welfare or, to use the vaguer but more voguish term, "happiness." Economists, and this includes those working for McCain, know that the value ("marginal utility") of a \$1,000 increase in income for someone earning \$60,000 per year exceeds the loss in value, even of a greater sum, to someone earning \$250,000 and more. So Obama can rightly claim that this one of his several tax proposals does not involve a tax increase, and makes

a lot of people much better off at the expense of making a few people only slightly worse off. Not bad policy.

Or is it? McCain's people will undoubtedly work the numbers to see if one can indeed take a chunk from a few Peters and get enough to add a consequential amount to lots of poorer Pauls. But even if the numbers don't support the feasibility of the Obama redistribution, I suspect that point will get lost in the welter of statistical claim and counterclaim. The take-away, as the pros in Washington call it, will be: Obama wants to tax those who have appropriated most of the benefits of the recent prosperity and share those benefits more fairly with those who have been left behind.

No, if McCain is to have an answer it must be based on a demolition of the basic Obama thesis that he can make many people better off by making a few worse off, and a demonstration that the Obama program satisfies neither the criterion of economic efficiency nor the (more potent) public notion of what is fair. It will be necessary for McCain to show that the recipients of Obama's \$1,000 gift will not be better off, and might indeed be worse off after the income transfer is completed. How could this be?

Taxes change behavior. By raising rates on upper income payers, Obama is reducing their incentive to work and take risks. The income tax increase is not all that he has in mind for them. He plans to increase their payroll taxes, the taxes they pay on dividends received and capital gains earned, and on any transfers they might have in mind to their kith and kin when they shuffle off this mortal coil. If the aggregate of these additional taxes substantially diminishes

---

*Irwin M. Stelzer is a contributing editor to THE WEEKLY STANDARD, director of economic policy studies at the Hudson Institute, and a columnist for the Sunday Times (London).*

JUNE 30, 2008

incentives to set up a small business of the sort that has created most of the new jobs in recent decades, the \$1,000 tax rebate will be more than offset by the consequences of reduced growth and new business formation.

There are two problems with this counterpunch. The first is that we have no idea whether it is true. The McCain campaign has shown little taste for doing the sort of empirical work on which the Obama team thrives. The second is that this is just the sort of exercise that McCain finds unappealing. At best, he will leave such matters to “surrogates.” Alas, the precise mechanics by which they will answer questions directed at their candidate during the town hall meetings he is proposing have not been worked out.

Perhaps, then, there is some sort of income redistribution with which McCain can be comfortable, the sort that increases faith in the fairness of the market capitalist system of which he is justifiably so fond, and which has produced greater prosperity for more people than any other economic system.

Surely the populist streak in the Arizona Republican leads him to find something wrong—yes, wrong—with the way executive compensation has become divorced from executive performance. And surely he would be comfortable calling for greater shareholder participation in the approval of executive compensation, and supporting the SEC’s recent efforts to require corporations to report just how they plan to relate executive compensation to performance.

Surely, too, McCain knows that paying mortgage brokers based on the quantity of business they generate creates incentives to imprudent lending. These are not the much-derided speculators, who actually take large risks with their own money, and who are the favorite target of politicians-on-the-make: These are people who have found a structural flaw in a market, and exploited it while imposing the costs of their activities on society. There’s a principle here that would permit

McCain to favor regulation—regulation that makes mortgage markets work better.

Then there is energy policy. It should be possible on the straight-talk express to devise some alternative to the patently cynical promise of “energy independence.” No such “independence” is within reach, as the successive failures of Presidents Nixon, Ford, Carter, Reagan, Clinton, and two Bushes to attain it should demonstrate. Leave that pandering to Obama, who would somehow achieve that goal while at the same time foreclosing drilling offshore and in Alaska, and killing the nuclear option by opposing

**Surely the populist streak in the Arizona Republican leads him to find something wrong—yes, wrong—with the way executive compensation has become divorced from executive performance.**

the opening of the Yucca Mountain nuclear waste repository, without which nuclear plant construction will be minimal.

McCain, meanwhile, need not feel stuck with his own oft-stated opposition to drilling in Alaska. First, he might point out that a policy appropriate when gasoline was selling for \$2 a gallon is not appropriate when it is headed towards \$5. Second, since the governor of Alaska has announced that she is eager for exploration to begin in ANWR, McCain can in good conscience apply to Alaska the position he has long taken in regard to offshore drilling in Florida and other states—that the decision should be left to those states. Finally, he might point out that now that we know we are in a long war with radical Islam, it is more than ever incumbent on us to make painful tradeoffs. One such is bearing any environmental consequences

of drilling in ANWR, consequences he can continue to regret, in order to achieve the more important goal of depriving Middle East funders of jihadists at least some of the billions now flowing to them by substituting domestic oil for imports.

The art of governing is the art of making just such tough decisions. The political risk of being accused of flip-flopping seems minimal. The voters are ahead of the politicians on this issue, and now lean towards making the most of our domestic resources. Besides, moving energy policy from the realm of economic policy into the realm of national security can only be to McCain’s advantage. He would certainly have a more coherent policy position if he argued that it is important to keep money out of the hands of bad guys, than if he continued attacking oil companies for what he calls “obscene profits.” After all, polls show that the voters know that it is OPEC, rising demand in China, and the refusal of producer countries to allow our companies to develop their resources—not big, bad oil companies—that are responsible for high oil prices.

McCain might go further, and build on his reputation for opposing earmarks and the worst machinations of the K Street crowd, by abandoning the cap-and-trade system he has been supporting, in part at the urging of his buddy, Joe Lieberman (the man who could have rid the nation of the scourge of Majority Leader Harry Reid, Chairman Patrick Leahy, and the like by voting with the Republicans to organize the Senate). McCain can part with Lieberman by pointing out that what seemed sound theory has turned out in practice to represent everything he opposes. The recent abortive trial run of the cap-and-trade system in Congress showed that it would be a lobbyists’ bonanza, as some interest groups scramble for permits to pollute, and other interest groups insert their snouts into the multi-billion-dollar trough that would be

made available to fund technologies of Friends of Nancy and Harry and assorted bureaucrats.

Finally, and this would require a leap of political courage, McCain should spend ten minutes with his adviser Douglas Holtz-Eakin, who I would guess is still recovering from his embarrassment at McCain's call for a cut in gasoline taxes, to discuss the opposite: a tax on oil products, especially gasoline and heating oil. This doesn't mean abandoning his opposition to higher taxes. Indeed, the point is not to raise federal revenues. Every dollar that comes in should be rebated, perhaps by reducing the payroll taxes of everyone earning less than, say, \$50,000 per year, the group Obama intends to benefit by raising taxes on those energetic small-business owners. The beneficiaries of the McCain shift in taxes from work to polluting, imported gasoline would see the reduction in taxes immediately—when they received their first salary check after the new regime was in place. But the main point is this: The money that the Saudis and other supporters of jihadists would otherwise get would be reducing the taxes of hard-pressed Middle America. Take that, Barack Obama. It's called straight talk.

My best guess is that none of this will come to pass. McCain has little interest in economic policy, and prefers the sort of intuitive, ad hoc reaction that unfortunately led him to support the continued closure of the Arctic National Wildlife Refuge, and more sensibly to rail against multi-million payoffs to executives who had almost brought their companies to ruin. His economic policies have been aptly described as the politics of personal honor, which is a nice way of saying incoherent. They will therefore likely continue to be a combination of the good, the bad, and the ugly. If he ends up a winner in the debates as often as Clint Eastwood did in his flicks, McCain's strategy will be vindicated. If not, we are in for an expansion of the role of government in economic life that will make Lyndon Johnson look like *laissez-faire*. ♦