How “Dated” Policies Hurt the Economy *(SB News-Press)*

(June 26, 2011) Government spending programs and taxes may have started with good intentions and feasible economic models to make them work, but the original financial metrics are no longer viable. The runaway spending going out, and the burdensome siphon drawing funds in, are both hopelessly broken. The “dated” policies of spending and taxation no longer resemble their original forms and intentions. Federal, state, and local wealth redistribution seek to maintain – and even expand – a plethora of budget entitlements and taxes, which are significant hindrances to a thriving economy and robust job creation.

Social security and Medicare/Medicaid are the primary examples of entirely outdated spending. The Social Security annual report for 2010 shows 157 million workers paying in, with about 53 million taking benefits out, a ratio of just 2.9-to-1. It is the largest single federal budget line item (20.8 percent), just ahead of discretionary defense (20.5 percent), with Medicare/Medicaid (20.1 percent) in third place. Let’s review social security first. In 1937, workers began paying in, and by 1940 there were 35.4 million individuals contributing. By 1950 there were 48 million paying in and the ratio had dropped to just 16-to-1. Ten years later it was 5-to-1 with 72 million contributing, and then the ratio hit just over 3-to-1 in 1975, and remained at about 3.3-to-1 all the way through 2009 before it dropped to its current level. Assuming quarterly compounding, workers paying in since 1940 have increased at a 2.15 percent annual rate, from about 35 million to just under 157 million; but beneficiaries grew by 7.91 percent in that same time.

The annual surplus between workers paying in, and those drawing benefits out, creates a cumulative "trust fund" (on paper). This grew to just over $2.5 trillion by 2010. But those funds are "invested" in U.S. Treasury debt (T-bills, T-notes, T-bonds) – some 21 percent of our government's $14.3 trillion of outstanding obligations. It is projected there are only 4 to 5 *surplus* years remaining (up through 2016) before the program begins running annual deficits (paying out more than it collects), and that will grow larger every year. Conceptually it will draw from its Treasury "trust" to cover each annual shortfall. However, that only works for 20 years, after which the annual deficit must be made up with new taxes – and these would have to increase every year to fund a larger and larger shortfall. The problem is essentially the same for Medicare/ Medicaid, except it is projected to go bankrupt in just six years.

Economic common sense recognizes the population is living longer and rising healthcare costs far outpace inflation. Clearly these $1.45 trillion spending policies – a combined 41 percent of federal spending – is dated and no longer viable. But rather than radically reform these financial anachronisms, President Obama's plan is to raise taxes, believing that will simply bring in the additional revenue to fund these burdensome entitlements. However, the U.S. tax system is equally dated and no longer viable, and here's why.

The "income tax" was instituted in 1861 to pay for the Civil War, was repealed in 1871, and passed again by Congress in 1894 before the U.S. Supreme Court ruled it unconstitutional in 1895. But in 1913 the 16th Amendment permitted the federal government to tax income at the "national" level, irrespective of any state's relative population. For the last 100 years, the low-end and high-end tax rates and earnings continue to defy logic. The baseline 1913 rates were a 1 percent tax on the first $20,000 of income – up to 7 percent on earnings over half a million dollars. And that 1+7 system produced a federal budget surplus. So what happened?

The low-end grew to 10 percent on $14,000 by 2008, and taxes ballooned from $40 on $4,000 to $1,400 on $14,000 95 years later. So while the low-end income bracket rose 3.5 times, the taxes paid went up 35-fold! Marginal high-end tax brackets have moved all over the place, but in 95 years, the top-end has increased dramatically from the original 7 percent above $100,000 to 35 percent above $357,000. So the top income went up 3 ½ times, but the tax rate on that has grown 5-fold. In 2008, just the top 1 percent of taxpayers accounted for 38 cents of every tax dollar the IRS collected. The top 5 percent – just 1 person in 20 nationwide – accounted for almost 60 cents. And yet, that top five percent earns less than one third of all income (30.6 percent). That means the remaining 95 percent of taxpayers (95 out of 100 people) earn 70 percent of all income, but only pay in 41 cents on every 100 dollars of income tax. Twenty years ago, the top half of taxpayers accounted for 94 percent of all individual taxes collected, but today they cover over 96 percent, while the other half of taxpayers pay in just 3.6 percent. And the news is even worse for American business, as 35 percent corporate taxes are the second highest in the world (Japanese firms pay 39.5 percent). So what is the president's plan? Raise taxes even further on top individual earners, and higher corporate taxes.

In the six decades since WWII, taxes have averaged around 19 percent of the total domestic economy (Hauser's Law). That's almost one fifth of all economic activity! But more taxes and higher tax rates have led to less economic growth and therefore less tax revenues collected. However, lower tax rates spur stronger economic growth, which translates into more tax revenues coming in, and about the same 19 percent ratio. High tax rates are a well-documented deterrent to business formation and profit opportunities. All of these repeated increases in tax rates and higher taxable income levels are due to politicians needing more of the private sector's funds to be siphoned off to pay for "government knows best" spending programs. Which makes more sense, a $14.6 trillion economy with $2.7T in tax revenues collected, or a $15.2T economy with $2.9T collected? The latter is a win-win: a larger economy, stronger profits, robust job creation, AND more revenue for the government. If fiscally irresponsible politicians are simply looking for more tax dollars to spend on entitlements, wouldn't they actually want the economy to grow as much as possible? But the opposite is the policy of the Obama Administration. Higher taxes have stifled economic growth and crippled job creation (smaller economy in the denominator) resulting in less tax revenues coming in (smaller numerator). And increased government spending on more programs (with less tax revenues collected) has required outrageous federal borrowing to cover these deficits.

The IRS code was 400 pages in 1913. Today it's almost 72,000 pages. But the lack of basic common sense like eliminating inheritance taxes, capital gains, and double-taxing dividends remains the norm. America needs leaders who will reform dated spending and tax policies, to reduce government intrusion and simplify compliance. Then the private sector will begin investing capital, which will create new jobs, which will grow the economy. Common sense is never dated.