GDP Drives Government, Not The Other Way Around *(SB News-Press)*

(July 28, 2012) The Commerce Dept. just reported GDP “grew” at a paltry 1.5 percent annual pace for the second quarter 2012. That means the economy is larger by less than 8/10th of 1 percent from January through June. There is so much confusion and misinformation about which comes first, the economy or the government? Well, those billions and trillions of dollars in federal spending you read and hear about come from only two sources, either: 1) taxes on the private sector economy, or 2) Treasury borrowing. Government doesn’t make anything (except a mess of whatever business enterprise it gets involved in), and doesn’t create anything (except barriers to individual and business freedoms in the market). So it should be painfully obvious that there is no economic recovery happening, no meaningful job creation, and yet Obama continues to spend at his own record-levels. But Mr. President, government doesn’t drive the U.S. economy, GDP drives government’s very existence. Here’s how it works.

Government is not a creator of wealth – simply a consumer of others’ resources – such that all federal spending has to begin with a productive economy. When businesses are actively investing capital to expand infrastructure, grow sales, and increase profits, then millions of new jobs are created, and companies and individuals have more and more revenue and wages coming in. Those are the dollars the IRS taxes to bring in government revenues. The first concept of *Federal Financial Management 101* (I know, that’s an oxymoron) requires a vibrant, expanding, sustainable economy – otherwise, the tax base is smaller, which means tax revenues collected are lower.

Almost half of those government tax revenues come from the payroll taxes on people's wages, the other half comes from income taxes – and yes, they ARE two different taxes on the same income. Sixty years ago, the mix of income taxes was this: 67 percent of income tax revenues came from individuals, while 33 percent came from corporations. By 1970, that had shifted to 75 percent individuals and 25 percent corporations, and in 1980 it was an 80/20 split. Today it's 83/17 and on track to be 85/15 by 2016. The reason? U.S. corporate tax rates are so high compared to the rest of the world (No. 2 behind Japan), that firms must utilize multi-faceted and very elaborate legal tax avoidance strategies to leverage their maximum deductions, deferrals, and exemptions, and so the true net tax revenue on corporate activity continues its decades-long decrease.

In fact, that same trend is happening to individual taxpayer revenues as well. In 1980, combined corporate and individual income tax revenues equaled 10.7 percent of GDP. At the peak of the dot.com bubble in 2000, it was up to 12.2 percent. But in 2010, it slipped to just 7.5 percent of GDP, and early estimates for 2011 have it down to just 7.3 percent compared to the economy.

Going back six decades, the IRS has brought in, on average, combined tax dollars (income, payroll, excise, capital gains, death, dividends, etc...) of about 18-to-19 percent of GDP. In 2000, it hit 20.5 percent, and was still 17.6 percent in the last year of Bush (2008). But in the four years of Obama, that has slipped precariously to only 15 percent in 2009, 14.9 percent in 2010, will be 15.3 percent for 2012, and is projected to be 14.8 percent in 2013. This means that if U.S. GDP is barely growing and less people are working (only 69,000 jobs added in May, and 8.2 percent "official" unemployment – over 12 percent "true" unemployment), total payroll taxes brought in are lower, AND businesses have less revenue and taxable income, so the net effective rate of actual tax dollars collected on the economy will continue to shrink.

The worst part is how government spends those tax revenues. Spending is increasingly comprised of mandatory allocations, without any discretion over these escalating amounts. The "Big-3" entitlements are Social Security, Medicare, and Medicaid. In 1940, there were 159 workers paying in to Social Security for each person paid a benefit. By 1960, that dropped to 5-to-1, and in 2000 it was just 3.4-to-1. It is now less than 3-to-1 (and dropping), as expanded required benefits are paid out to more recipients joining the entitlement ranks each year. Prior to 2008, the annual paid in was greater than the benefits paid out. But since 2009, benefits paid are greater than the payroll taxes collected. This annual shortfall will continue to widen from here on, as these will consume 43 percent of the federal budget in 2013, 48 percent in 2017, and hit 57 percent in just ten years.

Each annual deficit then gets added to the perpetual pile of accumulated debt. Clinton had 3 surplus years and 5 deficits. This added $1.27 trillion to the total debt in 8 years and brought it to $5.62 trillion – an average annual deficit of $158 billion. In the post-911 eight years of Bush, there was one surplus and seven deficits, adding $4.22 trillion in debt to a new total of $9.98 trillion – $522 billion average per year. But in the four years of Obama, average deficits are $1.33 trillion, adding $5.33 trillion debt in just four years – $16.35 trillion total. His 2013 proposed spending would run another $1.1 trillion shortfall and total debt would hit $17.4 trillion. That translates to 36 percent of our nation's debt being added in just 5 years.

Heading into November, we're at a crisis point. The president's plans for more and higher taxes will keep the economy flat, while Obamacare costs, trillion-dollar budget deficits, and no action on entitlement reform will escalate the debt from its current level of 105 percent of GDP, to 129 percent in 2017, and 163 percent in just ten years. More government spending will not fuel economic growth – only larger deficits and more debt. The complete crisis is exposed in our new book, and I'll cover more details in my next three monthly columns heading up to the election.